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POSTAL RATE COMMISSION

In the Matter of:)
)
WASHINGTON MUTUAL BANK NSA) Docket No. MC2006-3
)

Suite 200
U.S. Postal Rate Commission
901 New York Avenue, N.W.
Washington, D.C.

Volume #2
Monday, July 31, 2006

The above-entitled matter came on for hearing pursuant to notice, at 10:02 a.m.

BEFORE:

HON. GEORGE A. OMAS, CHAIRMAN
HON. DAWN A. TISDALE, VICE CHAIRMAN
HON. RUTH Y. GOLDWAY, COMMISSIONER
HON. TONY ~~A.~~ HAMMOND, COMMISSIONER

APPEARANCES :

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C O N T E N T S

WITNESSES APPEARING:

ALI AYUB

MICHAEL RAPPAPORT

VOIR

WITNESSES:DIRE

	<u>DIRECT</u>	<u>CROSS</u>	<u>REDIRECT</u>	<u>RECROSS</u>	
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E X H I B I T S

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P R O C E E D I N G S

(10:02 a.m.)

CHAIRMAN OMAS: Good morning. Today we are holding hearings in Docket No. MC2006-3 to receive testimony of witnesses supporting the Postal Service's request for an opinion and recommended decision on a proposed baseline negotiated service agreement with Washington Mutual Bank.

Two witnesses are scheduled to appear today. They are Witnesses Ayub and Rappaport. Does anyone have any procedural matters to discuss before we begin today?

(No response.)

CHAIRMAN OMAS: Mr. Alverno, would you please identify the Postal Service witness so I can swear him in?

MR. ALVERNO: Thank you, Mr. Chairman. The Postal Service calls Mr. Ali Ayub.

CHAIRMAN OMAS: Raise your right hand.

Whereupon,

ALI AYUB

having been duly sworn, was called as a witness and was examined and testified as follows:

CHAIRMAN OMAS: Please be seated.

//

1 DIRECT EXAMINATION

2 BY MR. ALVERNO:

3 Q Please introduce yourself.

4 A I'm Ali Ayub, and I work in the Office of
5 Pricing Strategy for the U.S. Postal Service.

6 MR. ALVERNO: Mr. Ayub, earlier I handed you
7 two copies of a document entitled "Direct Testimony of
8 Ali Ayub on behalf of the U.S. Postal Service," marked
9 as USPS-T-1. I have now given those two copies to the
10 reporter.

11 (The document referred to was
12 marked for identification as
13 Exhibit No. USPS-T-1.)

14 BY MR. ALVERNO:

15 Q Did you have a chance to examine those
16 copies?

17 A Yes. I have examined those copies.

18 Q And was this testimony prepared by you or
19 under your direction?

20 A Yes. It was prepared under my direction.

21 Q And does that testimony include errata that
22 you filed on June 7 and June 8, as well as
23 supplemental testimony filed on June 8, and errata
24 filed on June 13?

25 A Yes, it does.

1 Q Do you have any other changes or corrections
2 to make?

3 A No, I do not.

4 Q And if you were to testify orally today,
5 would your testimony be the same?

6 A Yes, my testimony would be the same.

7 MR. ALVERNO: Mr. Chairman, I ask that the
8 direct testimony of Ali Ayub on behalf of the U.S.
9 Postal Service, marked as USPS-T-1, be received as
10 evidence at this time.

11 CHAIRMAN OMAS: Is there any objection?

12 (No response.)

13 CHAIRMAN OMAS: Hearing none, I will direct
14 counsel to provide the reporter with two copies of the
15 corrected direct testimony of Ali Ayub. That
16 testimony is received into evidence. However,
17 consistent with Commission practice, it will not be
18 transcribed.

19 (The document referred to,
20 previously identified as
21 Exhibit No. USPS-T-1, was
22 received in evidence.)

23 CHAIRMAN OMAS: Mr. Ayub, have you had an
24 opportunity to examine the packet of designated
25 written cross-examination that was made available to

1 you in the hearing room this morning?

2 THE WITNESS: Yes, I have.

3 CHAIRMAN OMAS: If the questions contained
4 in that packet were posed to you orally today, would
5 your answers be the same as those previously provided
6 in writing?

7 THE WITNESS: Mr. Chairman, we have two
8 corrections to make.

9 The first is OCA USPS-T1-12, Subpart C. The
10 correct entry should read: "I believe Washington
11 Mutual Bank will mail in the range of 590 million
12 first-class mail marking pieces in Year 1."

13 In OCA 34, the correct answers should be
14 "Revenue at 490 million pieces is \$250,000," not
15 \$25,000.

16 CHAIRMAN OMAS: Counsel, would you please
17 provide two copies of the corrected designated written
18 cross-examination of Witness Ayub to the reporter?
19 That material is received into evidence and is to be
20 transcribed into the record.

21 (The document referred was
22 marked for identification as
23 Exhibit No. OCA USPS-T1-12
24 and was received in
25 evidence.)

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

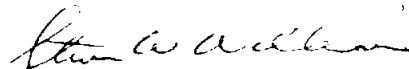
Rate and Service Changes to Implement
Baseline Negotiated Service Agreement
with Washington Mutual Bank

Docket No. MC2006-3

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF UNITED STATES POSTAL SERVICE
WITNESS ALI AYUB
(USPS-T-1)

<u>Party</u>	<u>Interrogatories</u>
Office of the Consumer Advocate	OCA/USPS-T1-1-3, 5-6, 10, 12, 14-16, 19, 24-27, 29-34
Postal Rate Commission	POIR No. 1, Questions 5-8 POIR No. 2, Question 1
Valpak Direct Marketing Systems, Inc. and 'Valpak Dealers' Association Inc	VP/USPS-T1-1-2, 4-25

Respectfully submitted,



Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
UNITED STATES POSTAL SERVICE
WITNESS ALI AYUB (T-1)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
OCA/USPS-T1-1	OCA
OCA/USPS-T1-2	OCA
OCA/USPS-T1-3	OCA
OCA/USPS-T1-5	OCA
OCA/USPS-T1-6	OCA
OCA/USPS-T1-10	OCA
OCA/USPS-T1-12	OCA
OCA/USPS-T1-14	OCA
OCA/USPS-T1-15	OCA
OCA/USPS-T1-16	OCA
OCA/USPS-T1-19	OCA
OCA/USPS-T1-24	OCA
OCA/USPS-T1-25	OCA
OCA/USPS-T1-26	OCA
OCA/USPS-T1-27	OCA
OCA/USPS-T1-29	OCA
OCA/USPS-T1-30	OCA
OCA/USPS-T1-31	OCA
OCA/USPS-T1-32	OCA
OCA/USPS-T1-33	OCA
OCA/USPS-T1-34	OCA
VP/USPS-T1-1	Valpak
VP/USPS-T1-2	Valpak
VP/USPS-T1-4	Valpak
VP/USPS-T1-5	Valpak
VP/USPS-T1-6	Valpak
VP/USPS-T1-7	Valpak
VP/USPS-T1-8	Valpak
VP/USPS-T1-9	Valpak
VP/USPS-T1-10	Valpak
VP/USPS-T1-11	Valpak
VP/USPS-T1-12	Valpak

Interrogatory

VP/USPS-T1-13

VP/USPS-T1-14

VP/USPS-T1-15

VP/USPS-T1-16

VP/USPS-T1-17

VP/USPS-T1-18

VP/USPS-T1-19

VP/USPS-T1-20

VP/USPS-T1-21

VP/USPS-T1-22

VP/USPS-T1-23

VP/USPS-T1-24

VP/USPS-T1-25

POIR No. 1, Questions 5-8

POIR No. 2, Question 1

Designating Parties

Valpak

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PRC

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OCA/USPS-T1-1. Please refer to your testimony at page 15, lines 9-10. You identify rising interest rates and a weaker economy as market conditions that inhibit mail volume growth in the credit card industry.

- a. Do changes in *expected future* interest rates or in the *expected future* state of the economy affect the solicitation mail volume of credit card companies? If so, please explain how.
- b. For each year of the proposed NSA, please state your beliefs as to the direction of change of interest rates and the direction of change of the state of the economy.
- c. Did your beliefs (as to changes in interest rates or in the state of the economy over the term of the NSA) change during the course of negotiations with WMB? If so, how did your changing beliefs affect volume estimates, the final level of discounts, or thresholds adopted?
- d. If interest rates or the state of the economy actually differ from current expectations during the term of the NSA, will after-rates volumes differ from forecasts? Please explain your response.

RESPONSE:

a) Changes in "expected future interest rate or in the expected future state of the economy" may impact solicitation volumes. However, the impact of these variables on mail volume cannot be evaluated independently of other market conditions such as: consolidation within the industry, lower response rates, legislative changes, market saturation, and increases in postage costs. *Ceteris paribus*, rising interest rates generally tend to create downward pressure on total credit card solicitation volumes. Similarly, declines in economic activity in could also result in reductions in mail volumes.

b) I did not independently forecast either interest rates or the state of the economy in developing the analysis. With respect to interest rates, upon raising the short-term interest rates on March 28, 2006 to 4.75%, the Federal Open Market Committee stated as follows:

The Committee judges that some further policy firming may be needed to keep the risks to the attainment of both sustainable economic growth and price stability roughly in balance. In any event, the Committee will respond to changes in economic prospects as needed to foster these objectives.

This appears to imply that short-term interest rates may continue to rise or will remain at current rates. However, other people may interpret these signals differently.

c) Neither factor standing alone resulted in a change in our evaluation of the volume estimates. Over the course of our discussions with WMB, we analyzed WMB initial volume estimates using the tools and analytical methods described in my testimony.

d) If a variable causes a change in the before-rates forecast, holding all other factors equal, it should have a similar impact in the same direction on the after-rates forecast

OCA/USPS-T1-2. Please provide your understanding of the process that generates "lift." Include an explanation of why two pieces that differ only in indicia should have different response rates.

RESPONSE: Generally speaking, it is my understanding that the indicia, speed of service, and forwarding services are factors that independently or combined may contribute to "lift". For example, the forwarding service offered for First-Class Mail provides a lift over a Standard Mail piece because a recipient is more likely to receive a First-Class solicitation if he or she has moved and a forwarding order is on file. In addition, lift may occur based on the subjective judgments of recipients. The open and read rates for First-Class Mail tend to be higher than Standard Mail. For more discussion on the lift from First-Class Mail, please see Witness Buc's testimony in Docket No. MC2004-3.

OCA/USPS-T1-3. Please explain why volumes eligible for discounts are not capped at WMB's after-rates volume estimates. Include an explanation of how such a cap would alter WMB's mailing behavior.

RESPONSE: Volumes eligible for discounts are not capped at WMB's after-rates volume estimates because that could potentially discourage additional growth of WMB First-Class Mail marketing volumes.

OCA/USPS-T1-5. Please refer to your testimony at page 1, lines 11-12.

- a. Please confirm that the Postal Service's first and second Data Collection Reports for the Capital One NSA, filed with the Commission on January 31, 2005, and February 7, 2006, respectively, were prepared by you or under your supervision. If you do not confirm, please explain. If you participated in any capacity in the preparation of these Data Collection Reports, please identify the enumerated requirements in the reports in which you participated and your capacity.
- b. Please confirm that the Postal Service's first Data Collection Report for the Bank One NSA, filed with the Commission on February 7, 2006, was prepared by you or under your supervision. If you do not confirm, please explain. If you participated in any capacity in the preparation of this Data Collection Report, please identify the enumerated requirements in the report in which you participated and your capacity.
- c. Please confirm that the Postal Service's first Data Collection Report for the Discover NSA, filed with the Commission on February 7, 2006, was prepared by you or under your supervision. If you do not confirm, please explain. If you participated in any capacity in the preparation of this Data Collection Report, please identify the enumerated requirements in the report in which you participated and your capacity.

RESPONSE:

- a. Confirmed. I was responsible for collecting information and providing analyses for the Data Collection Report.
- b. Confirmed. I was responsible collecting information and providing analyses for the Data Collection Report.
- c. Confirmed. I was responsible collecting information and providing analyses for the Data Collection Report.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF THE OFFICE OF CONSUMER ADVOCATE**

OCA/USPS-T1-6. This interrogatory seeks information that could assist in the evaluation of financial risk to the Postal Service from the proposed NSA.

a. Article II, Paragraph F, of the NSA refers to a "published figure" for "domestic active credit card accounts."

i. Where is this figure published?

ii. Please provide this figure for 2003, 2004, and 2005.

b. Article II, Paragraph C, subparagraph 3, of the NSA states that correspondence with non-cardholders will count toward thresholds.

i. Did you or the Postal Service inquire of WMB as to previous annual volumes of such correspondence? If so, what was the response? If not, why not?

ii. Please provide the annual volumes of such correspondence for 2003, 2004, and 2005.

iii. Is such correspondence considered "customer mail" or "solicitation mail" for purposes of Article II, Paragraph K, subparagraph 1, of the NSA?

iv. Does such correspondence count toward the volume commitment of Article II, Paragraph J, of the NSA?

v. Is such correspondence included in the graph on page 18 of your testimony? If so, where?

c. Article II, Paragraph J, of the NSA is entitled "Solicitation Mail Volume Guarantee." It includes the sentence, "If, in any year, Washington Mutual fails to meet this commitment, *the Postal Service may terminate this agreement*, and Washington Mutual will pay the Postal Service \$250,000." (Emphasis added.)

Docket No. MC2006-3 - 3 -

i. Is the payment of \$250,000 contingent on the Postal Service's terminating the agreement?

ii. Why is there a termination clause here, given the unconditional right of the Postal Service to terminate at any time under Article IV, Paragraph F, of the NSA?

d. Article III, Paragraph D, of the NSA requires WMB to pay \$250,000 if it fails to mail at least 375 million First-Class Mail pieces in Year 1.

i. Is this \$250,000 in addition to the \$250,000 penalty in Article II, Paragraph J, of the NSA? If not, why not?

ii. Why is there no termination clause in Article III, Paragraph D, given that there is such a clause in Article II, Paragraph J, of the NSA?

iii. If WMB fails to mail at least 375 million First-Class Mail pieces in Year 1 *and* the Postal Service terminates the agreement, would WMB owe \$500,000 to the Postal Service? If not, why not?

iv. If WMB mails 490 million First-Class Mail pieces in Year 1 *and* the Postal Service terminates the agreement, how much would the Postal Service make from the agreement? Please provide all calculations and sources used.

v. What is your current estimate of the likelihood that WMB will fail to mail at least 375 million First-Class Mail pieces in Year 1?

vi. What is your current estimate of the likelihood that WMB will fail to meet its commitment under Article II, Paragraph J, of the NSA?

vii. What is the expected value to the Postal Service of the two \$250,000 penalty clauses in the NSA?

e. Article II, Paragraphs F, G, and I, of the NSA contain threshold adjustment clauses.

i. Are there any other threshold adjustment clauses in the NSA? If so, please identify them.

ii. If WMB were to mail 900 million First-Class Mail pieces in Year 1, would this volume, by itself, trigger a threshold adjustment for Year 2? If so, how?

f. Are there risk mitigation provisions in the NSA other than those previously discussed in this interrogatory? If so, please identify them.

RESPONSE:

a) i). This figure will be provided each year to the Postal Service by WMB.

ii). Based on previous Providian Annual Reports, the figures are as follows:

2003 – 10.4 million

2004 – 10.2 million

2005 - 10.0 million (estimated)

The Postal Service also uses data from industry reports produced by Synovate, Card Data, Forrester, CompereMedia. In addition, we evaluate data from regulatory filings with the SEC, FTC, and other government agencies.

b) i.) We discussed the volume of such correspondence and determined that this correspondence represented less than one percent of WMB total First-Class Mail volume. This factor is consistent with observations from other NSA discussions.

ii.) The volume represented by this portion is less than one percent of total volume for 2003, 2004 and 2005. Because this volume is associated with permits that comprise mail to existing card holders, the Postal Service does not have information that would allow it to provide the requested information.

iii.) Such correspondence is considered customer mail.

iv.) No.

v.) No.

c) i.) The penalty is contingent on the Postal Service terminating the agreement.

ii) Article II, Paragraph J, describes a special situation where the Postal Service terminates for cause and provides a unique remedy in conjunction with the exercise of that authority. In this sense, it is distinct in purpose from the provisions and remedies for termination in Article IV, paragraph F.

d) i.) The penalties in Article III, Paragraph D, are independent from those in Article II, Paragraph J. If WMB mail volume is less than 375 million First-Class Mail pieces in Year 1, but the percentage of First-Class Mail marketing pieces is greater than 90 percent, then the only penalty that will be applied is the \$250,000 penalty identified in Article III, Paragraph D.

ii) The unconditional right to terminate under Article IV, Paragraph F, provides for termination, and a special termination clause for this provision was not negotiated.

iii) No Please see response to (d)(i) above.

iv.) An estimate of value based only on total First-Class Mail pieces could not be made without knowing the proportions of volume classified as marketing and customer mail.

v.) We do not possess any estimates of the likelihood that WMB will fail to mail at least 375 million First-Class Mail pieces in Year 1. Based on the testimony of Witness Rapaport, I believe that there is a solid basis to conclude that WMB will mail more than 375 million pieces.

vi). The Postal Service has filed this NSA with the expectations that WMB will be able to meet the commitment in Article II, Paragraph J.

vii). The value of penalty clauses to the Postal Service is to ensure that NSA customers are committed to the NSA process. The penalty clauses respond to objections raised in other NSA proceedings.

e) i.) No.

ii.) No.

f) Risk mitigation in the NSA process consists of addressing risks in contract performance. Risks can also be mitigated by performing the type of in-depth analysis we used to in our evaluation of the data used to develop the NSA.

OCA/USPS-TI-10. This interrogatory seeks information that could be used to reduce financial risk to the Postal Service from the Washington Mutual Bank (WMB) NSA. Please refer to your response to OCA/USPS-T1-1a. In this response you say that "the impact of these variables on mail volume cannot be evaluated independently of other market conditions such as: consolidation within the industry, lower response rates, legislative changes, market saturation, and increases in postage costs." Please consider a situation where several variables other than postage costs differ in the future from expectations during negotiations.

- a. Could such differences cause actual after-rates volumes to differ from forecasted after-rates volumes? If not, why?
- b. Does the possibility of such differences create financial risk for the Postal Service from the WMB NSA? If not, why?
- c. Do you understand the expression "risk management"? If so, please describe your understanding and explain how the Postal Service generally manages the risk of interest rates' or gas prices' differing in the future from current expectations.
- d. Do you know whether firms in the credit card industry engage in risk management? If so, please describe how such firms might manage the risk of interest rates' differing in the future from current expectations.
- e. Do you understand there to be a difference between "risk management" and "risk mitigation," as the latter term is used at page 29, line 17, of your testimony? If so, is it possible to manage a risk that cannot be mitigated? If so, how?
- f. You have stated in your testimony at page 29, lines 15-17 that "part of the Postal Service analysis is to identify the sources of variability, whether technical or financial, and to manage and reduce the variability." Please list all "sources of variability" that you have identified with respect to the WMB NSA.
- g. You have stated in your testimony at page 28, lines 4-5 that "the Postal Service has attempted to point to exogenous factors that might affect mail volumes" Please list all such factors of which you are aware.
- h. Under the terms of the proposed NSA, and assuming that WMB fulfills all other terms of the NSA, does WMB have the right, but not the obligation, to purchase unlimited quantities of First-Class solicitation mail? Please provide the basis for your response, including citations to DMCS and/or NSA provisions where appropriate.

RESPONSE:

- a) Generally speaking, when used in financial terms, the term "risk" is synonymous with variation. Thus, the financial risk inherent in NSAs is that the actual value will vary (in either direction) from the expected value. If expressed in terms of mail volume, the

risk is that the actual volumes will vary from the projected volumes. The question appears to suggest that variance from the volume projections of any kind is to be avoided at all costs, and that positive and negative variances are undesirable. In this instance, it should be pointed out that the financial impacts of these two kinds of variance are asymmetrical. In general, if volumes exceed expectations, there is some probability that the Postal Service will have paid out more in NSA incentives than planned; however, the Postal Service could gain substantial contribution that will exceed any incentives that are paid. On the other hand, if volumes fall short of projections, then the Postal Service could pay less in incentives than planned, but could be worse off financially because of the loss of high contribution First-Class Mail.

It should be pointed out that forecasts – even those relating to fairly simple phenomena – often vary from actual experience. When projecting mail volumes over a three year horizon, where many variables interact, the probability of having a perfectly accurate forecast is, in our experience, small. Consequently, such differences could cause actual after-rates volumes to differ from forecasted after-rates volumes.

b) Under the terms of the WMB NSA, every piece of mail - even among those that receive the highest possible discount - is expected to yield positive contribution. This is because WMB volume in each discount tier exceeds the attributable cost of workshared First-Class Mail. If the after-rates volume is higher, there will be a positive financial impact on the Postal Service. However, if the after-rates forecast is less than projected, then the estimated financial value to the Postal Service is lower, but may still be contribution positive and therefore beneficial to the Postal Service.

c) My understanding of the concept of risk management is the use of tools and processes by an organization to manage uncertain variables. Additionally, risk management involves identifying which assets to "risk" in order to create value. Effective management of risk is necessary because fear of risk can mask the opportunity to create more value or threaten the value already being created. Finally, risk management is not only used to address economic risk, but also operational, market, and other types of risk. The challenge is to manage processes and assets in such a way so as to continue create value in the face of changing customer needs in a changing environment. I am not involved in developing risk mitigation strategies for the Postal Service in connection with changes in interest rates or gas prices, and cannot speak to the process used to manage those variables. However, I note that page 36 of the USPS 2005 Annual Report states:

In the normal course of business, we are exposed to market risk from changes in commodity prices, certain foreign currency exchange rate fluctuations, and interest rates. With the limited exception explained on the following page, we do not use derivative financial instruments to manage market risks.

d) It is my understanding that many firms in the credit card industry engage in risk management. However, not every company manages risk in the same manner. Generally speaking, it is my understanding that firms in the industry manage risk through a variety of economic and management tools, such as interest swaps, futures, options, and adaptive customer management processes. One means by which credit card firms manage risk is by having a very large base of customers. Portfolio theory counsels that diversification reduces risk; thus, having a large number of assets for

which returns are not positively correlated reduces the variance in outcomes of the whole. Interestingly, the NSA process that exists today – by limiting the financial viability of NSAs through protracted and costly litigation – serves to limit the Postal Service's ability to manage risk in this way.

e) My understanding of the concept of risk management is that it consists of the process of managing unknown variables. Risk mitigation is the usually the ultimate objective of risk management, whereby the adverse effects of unknown variables are understood, reduced, and/or neutralized.

f) Some of the variables we have looked at include: prime rate, federal funds rate, treasury rates, outstanding credit, unemployment indexes, wage rates, consumer price index, total consumption, inflation indexes, bankruptcy rates, consumer credit outstanding, employment cost index, charge-off rates, response rates, housing starts, personal income, household financial assets, percent of disposable income, producer price index, net income, number of cards outstanding, GDP, marketing spends/budgets, total credit card solicitation volume, type of cards, annual fees, card interest rates, consumer expenditure, number of card customers, delinquency rates, charge-off rates, and allowance for loss.

g) Exogenous factors may include the variables identified above. Moreover, it also includes regulatory and market factors that cannot be quantified. Examples of these factors are: changes in bankruptcy laws, changes in interest rate laws, allowances for bad debt, market consolidation, and life-cycle position. Interestingly, one of the variables that the Postal Service cannot control is time. When negotiating an NSA, the Postal Service and its customer must make assumptions about when an NSA will be

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF THE OFFICE OF CONSUMER ADVOCATE**

implemented. Because of lengthy and unpredictable litigation times, it is difficult to predict an implementation date, thereby reducing our ability to manage risk given the variables identified above.

h) WMB has the right to purchase unlimited quantities of mail under the terms of the agreement at contribution-generating rates for its *credit card-related mailings*. The agreement is not capped.

**RESPONSE OF USPS WITNESS AYUB TO INTERROGATORIES
OF THE OFFICE OF CONSUMER ADVOCATE**

41

OCA/USPS-T1-12. This interrogatory seeks to find a volume cap that would be satisfactory to the Postal Service. Please refer to your response to OCA/USPS-T1-3. Your response reads,

Volumes eligible for discounts are not capped at WMB's after-rates volume estimates because that could potentially discourage additional growth of WMB First-Class marketing volumes.

- a. If after-rates volume forecasts are accurate, given current expectations for variables other than postage costs, what would cause actual after-rates volumes to differ from forecasted after-rates volumes?
- b. Is it not the case that actual after-rates volumes in excess of forecasted after-rates volumes *must* be "anyhow volume"? Please explain your response.
- c. Do you expect WMB to mail in excess of 593 million First-Class solicitation pieces in Year 1?
- d. If WMB mails fewer than 593 million First-Class solicitation pieces in Year 1, would a 593-million-piece cap for Year 1 have an adverse effect on the Postal Service or WMB? If so, how?

RESPONSE:

a) The factors identified in OCA/USPS-T1-10(f) could cause this result.

b) No. It is not the case that actual after-rates volumes in excess of forecasted after-rates volumes "must be anyhow volumes." NSAs are a new tool that will impact the marketing decision processes of our customers. Currently, customers have very limited experience in utilizing these incentives. After implementing the NSA, customers may discover that they can expand the use of the new postage rates to target markets they previously had not considered in their forecast.

First-Class Mail Marketing

c) I believe WMB will mail in the range of 590 million pieces in Year 1.

d) It would depend on the circumstances that resulted in WMB mailing less than 593 million pieces. If WMB volume in Year 1 was 580 million pieces, and WMB refrained from sending a 25 million piece marketing campaign in the absence of a pricing incentive, then the cap would produce adverse effects for the Postal Service because it would not benefit from the additional positive contribution of the 25 million additional First-Class Mail pieces. Moreover, WMB could be adversely affected by a cap because it would not be able to gain revenue through any new business it could acquire through the mailing.

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OCA/USPS-T1-14. This interrogatory seeks information that could be used to reduce financial risk to the Postal Service from the Washington Mutual Bank (WMB) NSA. Please refer to the Commission's unanimous concurring opinion in the Bank One case.¹

[B]ank one has argued that it might send even more First-Class Mail than it currently forecasts if unlimited discounts are available to it. This potential benefit is insufficient to justify providing special discounts to any individual mailer.

- a. Does "[t]his potential benefit" exist with respect to the WMB NSA? If so, what is the current expected value of "[t]his potential benefit" to the Postal Service? Please show all calculations and source all numbers used.
- b. Is the existence of "[t]his potential benefit" consistent with a claim that volume forecasts "accurately reflect the environment within which [WMB] is operating"? USPS-T-1, page 23, line 23. Please provide the basis for your response.
- c. Is the existence of "[t]his potential benefit" consistent with a "total postage expenditure" of \$160 million? *Id.*, page 24, line 12. Please provide the basis for your response.

RESPONSE:

- a) This "potential benefit" exists in the WMB NSA, in that we expect WMB to mail more contribution-generating First-Class Mail volume under the proposed discount structure than under the existing rate schedule. The Postal Service has not calculated the expected value of this potential benefit.
- b) The forecasts of the NSA are based on the current operating environment. We expect that the NSA will affect WMB's operating environment. In particular, we believe that the rate incentives and penalties in the NSA will be successful in converting or encouraging new First-Class Mail marketing volume. This is consistent with the notion that the NSA would give rise to a potential benefit, in the form of new First-Class Mail volume that would not have been mailed but for the existence of the NSA.

¹ Docket No. MC2004-3, December 17, 2004, at 4.

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- c) A potential benefit is, by definition, an outcome that has potential, but is not a certainty. The potential postage expenditure of \$160 million referenced on page 24 of my testimony is an estimate of the amount of WMB's estimated marketing budget that could be committed to postage. In this sense, a portion of the \$160 million figure represents a potential benefit in that it includes an amount that WMB could spend on postage, including First-Class Mail, that it would not otherwise have spent absent the NSA.

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OCA/USPS-T1-15. This interrogatory seeks to determine how the WMB NSA differs materially from the Capital One NSA. Please list all elements of the WMB NSA, as proposed, that are functionally different from the Capital One NSA, *as proposed*.

RESPONSE:

The following contractual elements of the WMB NSA as proposed differ from corresponding provisions in the Capital One NSA.

- Annual Threshold Adjustment, Section II, Part F, of the contract.
- Merger, Acquisition or Purchase of a Portfolio, Section II, Part G, of the contract.
- Solicitation Mail Volume Guarantee, Section II, Part J, of the contract.

OCA/USPS-T1-16. This interrogatory seeks to determine how the WMB NSA differs materially from the Bank One NSA. In its opinion in the Bank One Case, the Commission stated,²

[T]he risk of losses from discounts on mail that would have been sent without the agreement, given the record of this docket, is a continuing concern.

Please identify all elements of the WMB NSA as proposed, that are functionally different from the Bank One NSA, *as proposed*.

RESPONSE:

The WMB NSA is distinguished from the Bank One NSA in that the former includes a Solicitation Mail Volume Guarantee in Section II, Part J, of the agreement. This sets the WMB NSA apart from all other prior NSAs, and serves to mitigate risk.

² PRC Op MC2004-3 at 4.

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OCA/USPS-T1-19. This interrogatory seeks information to clarify the Postal Service's estimate of unit revenue for the Washington Mutual Bank (WMB) NSA. Please refer to your testimony, Appendix A, page 3, cell A58, which states, in part,

WMB mail operations volume consisted of 170 million pieces,
however they were commingled mail volumes of WMB card
services mail pieces and mail from other Postal Service customers.

- a. Please explain how "commingled mail volumes" from "other Postal Service customers" can be described as "WMB mail operations volume."
- b. Please explain why "the Postal Service could not identify the exact breakdown based on this commingling."
- c. Please explain what is meant by the sentence, "We believe WMB operations mail volume will reflect this average."

RESPONSE:

- a. The mail service providers' (MSPs) data, permit information, and entry point data provided by WMB for its operations volume indicate 170 million pieces.

However, because that volume is tendered to the USPS through MSPs, and not by WMB, volume statistics derived from the mail service providers' data can include mail from other customers within that mailing. In the future, we can control for this because the WMB NSA requires that for future mailings, a unique permit be utilized for WMB's mail volume. The footnote in my testimony was not intended to imply that all 170 million pieces were WMB mail pieces. WMB identified and documented that its volume from these permits was 120 million pieces. The remaining 50 million pieces are not WMB mail volume; rather, the pieces originate from other customers of the MSPs and are commingled with WMB mail volume.

- b. Please see my response to Part (a).

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- c. The revenue and cost estimates for operations mail volume is based on the 170 million pieces. Without knowing the exact breakdown of the number of pieces that originated from WMB at the time of mailing, I believe that using the average revenue and cost estimates for those 170 million pieces should reflect the average rates and costs for WMB's 120 million pieces.

OCA/USPS-T1-24. This interrogatory seeks information on the proposed Data Collection Plan (DCP) for the Washington Mutual Bank (WMB) NSA. Please refer to your testimony, Appendix C, "WMB Financial Services NSA Proposed Data Collection Plan." Please identify and explain the rationale for any material changes in the proposed DCP from the Data Collection Plan recommended by the Commission in Docket No. MC2004-3, the BankOne NSA.

RESPONSE:

The data collection plan proposed in this docket is similar to those proposed by the Postal Service in previous NSAs with credit card issuers in First-Class Mail. There are a few differences, however. The differences between the proposed data collection plan in this docket and the Bank One data collection plan include the following:

- In the Bank One case, the Commission imposed a cap and additional data requirements on the Bank One Agreement. The Postal Service is not proposing a cap in this case.
- Some additions to the data collection plan in the Bank One case were incorporated as part of settlement discussions with interveners in Docket No. MC2004-3.
- In the case of Bank One, there were special provisions for marketing flats which are not at issue in the WMB NSA.

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OCA/USPS-T1-25. This interrogatory seeks to carry out the "Panzar" test for the Washington Mutual Bank (WMB) NSA. Please refer to your testimony at page 25-29, the "Value Factors/Elements."

- a. Please provide the First-Class own-price elasticity of demand for WMB. If you are unable to provide WMB's own-price elasticity of demand, please have WMB provide it. Please show all calculations, including inputs to all calculations and citations to any references used.
- b. Please provide the cross-price elasticity of demand for letters migrating from Standard Mail to First-Class Mail for WMB. If you are unable to provide WMB's cross-price elasticity of demand, please have WMB provide it. Please show all calculations, including inputs to all calculations and citations to any references used.
- c. If you or WMB is unable to provide the own-price or cross-price elasticity of demand requested in subparts (a) and (b), above, please provide the own-price or cross-price elasticity of demand that you recommend be used in the "Panzar" test. Also, please explain your reasoning in recommending the own-price or cross-price elasticities recommended.

RESPONSE:

a.-c. I believe that the relevant elasticities are the own-price elasticity for WMB's First-Class Mail and the elasticity of WMB's First-Class Mail with respect to the discount between First-Class Mail and Standard Mail (rather than the cross-price elasticity).

To calculate these elasticities, we would like to solve the following equation:

$$Q_1 = Q_0 \cdot \left(\frac{p_c}{p_d} \right)^{\epsilon_1} \cdot \left(\frac{d_0}{d_d} \right)^{\epsilon_d}$$

where Q_0 is the before-rates First-Class Mail volume (450 million)

Q_1 is the after-rates First-Class Mail volume (713 million)

p_0 is the before-rates average marginal price (.324)

p_d is the after-rates average marginal price (.274)

¹ See Opinion and Further Recommend Decision, Docket No. MC2004-3, Chapter V, An Alternative Model, at 29.

² See Chapter V, An Alternative Model, at 36.

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d_0 is the before-rates average marginal discount between First-Class Mail and Standard Mail (.12)

d_d is the after-rates average marginal discount (.07)

ϵ_p is the own-price elasticity

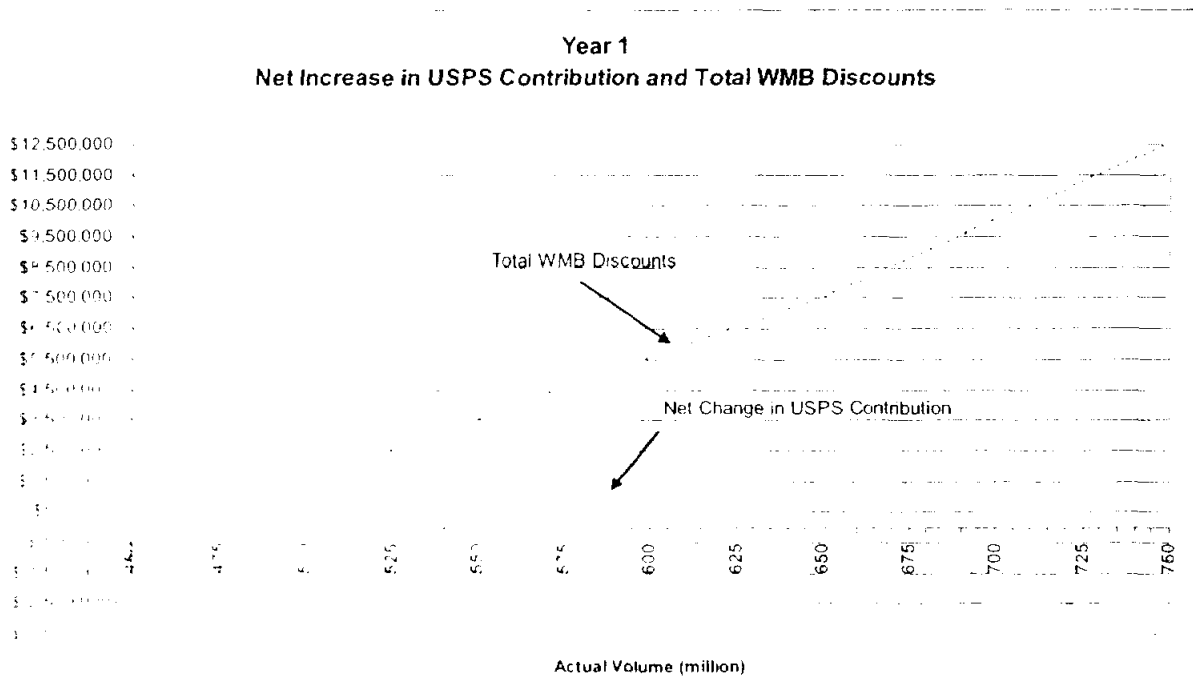
ϵ_d is the discount elasticity

However, because we have only one equation, it is impossible to calculate these elasticities. According to witness Rapaport's testimony, WMB makes mailing decisions based primarily on the relative prices of First-Class Mail and Standard Mail (WMB-T-1, p. 7 *et seq.*), which seems to indicate that the discount elasticity is a larger factor in WMB's mailing decisions, but this is the only guidance we have.

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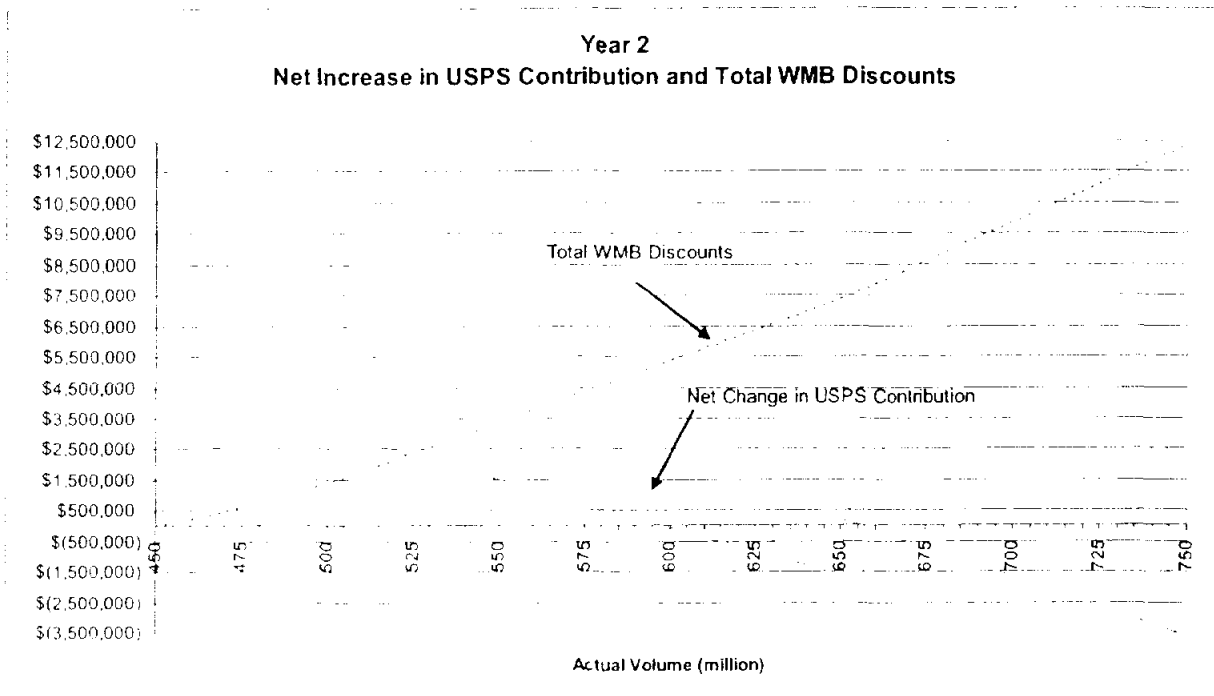
OCA/USPS-T1-26. This interrogatory seeks information that could be used to reduce financial risk to the Postal Service from the Washington Mutual Bank (WMB) NSA. Please refer to your testimony, Appendix A, the following charts entitled "Net Increase in USPS Contribution and Total WMB Discounts" for Years 1, 2, and 3 of the WMB NSA, and the accompanying electronic Excel file "OCA Exh1_Panzar Test-WMB."

- a. In Year 1, for volumes up to 596 million or between 651 million and 655 million, please confirm that the Postal Service will not lose First-Class Mail contribution under the WMB NSA, according to the Panzar test. If you do not confirm, please explain, and show all calculations and all sources used.

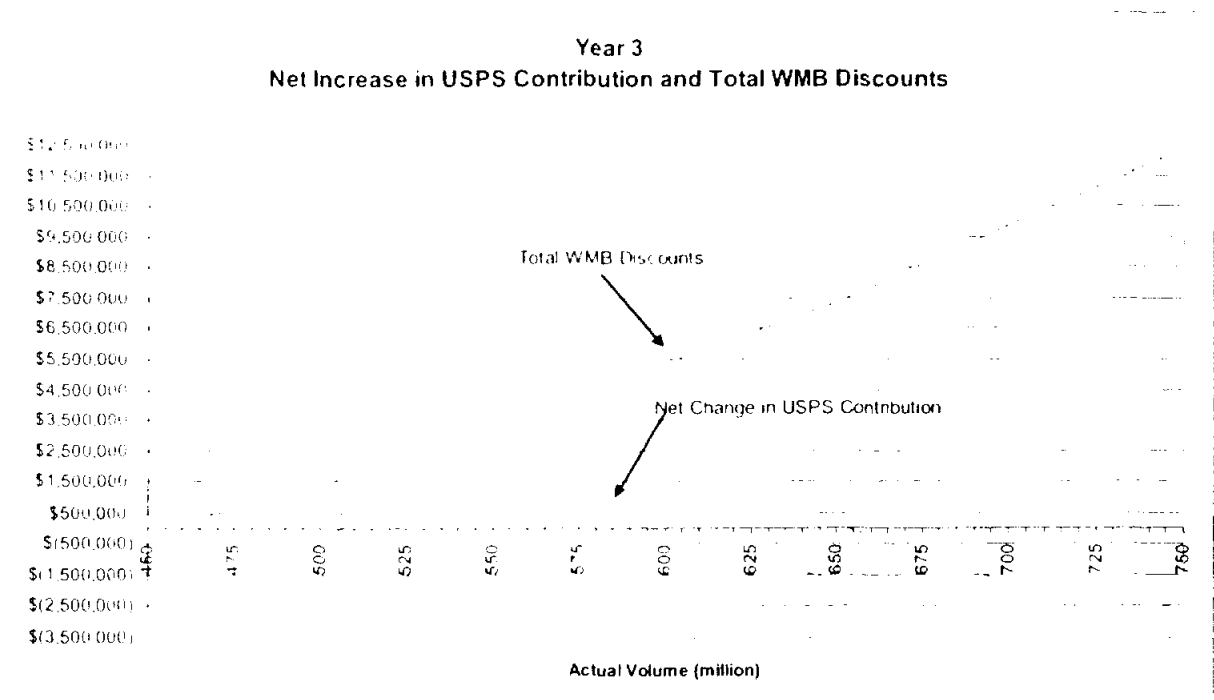


- b. In Year 2, for volumes up to 599 million or between 651 million and 657 million, please confirm that the Postal Service will not lose First-Class Mail contribution under the WMB NSA, according to the Panzar test. If you do not confirm, please explain, and show all calculations and all sources used.

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- c. In Year 3, for volumes up to 596 million or between 651 million and 654 million, please confirm that the Postal Service will not lose First-Class Mail contribution under the WMB NSA, according to the Panzar test. If you do not confirm, please explain, and show all calculations and all sources used.



RESPONSE: Confirmed that the calculations in the attached worksheet appear to have been performed correctly. However, the conclusions that have been drawn from these calculations depend completely on a set of underlying assumptions that are impossible to support. For example, the model supplied uses the own price elasticity of First-Class Mail presort as a proxy for Washington Mutual Bank's (WMB's) price elasticity for all points along WMB's demand curve. This is unlikely for several reasons: WMB uses First-Class Mail for several different purposes – acquisition, billing, and customer communication – each of which is likely to have a different own-price elasticity. Furthermore, as WMB's volume increases, the relative proportions of the different types of First-Class Mail will change, thereby affecting the overall weighted average own-price elasticity. Thus, an elasticity based on some type of weighted average, if one were to attempt to develop such an estimate, would vary with volume. The attached worksheet to this interrogatory does not account for these potential volume shifts and their effect on own-price elasticity.

OCA/USPS-T1-27. This interrogatory seeks information on the application of the “Panzar” test in order to identify technical issues involving the use of cross-price elasticities. Please provide a “Panzar” test based upon WMB’s before rates and after rates volumes under the proposed NSA, including the use of any cross-price elasticities of demand (if applicable). Also, please provide an explanation of your understanding of how cross elasticities would be applied in the “Panzar” test.

RESPONSE:

I have not performed a “Panzar test” on the WMB NSA, and it is not immediately obvious how such an analysis could be carried out.

As proposed by the Commission, the “Panzar test” requires testing for the inequality:

$$(p_d - c) \times (Q_1 - Q_0) - (p_0 - p_d) \times (Q_0 - Q_T) > 0 \quad (\text{eq. 1})$$

where p is price, c is marginal cost, Q is volume. The subscripts 0, 1, T, and d refer, respectively, to before-rates, after-rates, threshold, and discount. See Opinion and Further Recommend Decision, Docket No. MC2004-3 at 28. Equation 1, however, applies only where there is no migration between rate categories or subclasses that would affect the value of NSA. In the WMB NSA, such a migration is an important part of the deal, so we would need a modified version of Equation 1 that takes into account the conversion of Standard Mail letters to First-Class Mail:

$$(p_{F0} - c_F) \times (Q_{F1} - Q_{F0}) - (p_{F0} - p_{Fd}) \times (Q_{F0} - Q_{FT}) - (p_S - p_S) \times (Q_{S0} - Q_{S1}) > 0 \quad (\text{eq. 2})$$

where the additional subscripts F and S indicate, First-Class Mail and Standard Mail. The additional element “ $-(p_S - c_S) \times (Q_{S0} - Q_{S1})$ ” in Equation 2 eliminates the “double counting” of contribution from Standard Mail that is converted to First-Class Mail as a result of the NSA.

The Commission proposes testing the basic inequality expressed in Equation 1 by calculating:

$$Q_0 = Q_1 \cdot \left(\frac{p_0}{p_d} \right)^{\epsilon_p} \quad (\text{eq. 3}),$$

(where ϵ represents elasticity) for a wide range of Q_1 . See Opinion and Further Recommend Decision, Docket No. MC2004-3 at 28. Generalizing this form to account for migration of pieces, however, is not straightforward. From Equation 2, it is obvious that in the WMB case, it will be necessary to estimate not only the before-rates volume of First-Class Mail, Q_{F0} , but also the change in Standard Mail, $Q_{S0}-Q_{S1}$. Equation 3 cannot provide any such estimate using cross-price elasticities. Using a discount elasticity, similar to the one used by Witness Thress in Docket No. R2006-1 to model shifts between First-Class presort mail and Standard Mail regular (Docket No. R2006-1, Testimony of Thomas Thress, USPS-T-7, at 19), Equation 3 can be expanded to:

$$Q_0 = Q_1 \cdot \left(\frac{p_0}{p_d} \right)^{\epsilon_p} \cdot \left(\frac{d_0}{d_d} \right)^{\epsilon_d} \quad (\text{eq. 4})$$

where d represents the average discount between the price WMB pays for First-Class Mail letters and Standard Mail letters. This form does make more explicit the fact that First-Class Mail volumes change because of the change in the relationship between the prices for First-Class Mail and Standard Mail, but it fails to provide any information about the corresponding volume change in Standard Mail. Thus, in my opinion, the "Panzar test" cannot be easily generalized to account for cross-price effects.

OCA/USPS-T1-29. This interrogatory seeks information on the price elasticity for Washington Mutual Bank (WMB). Please refer to your response to OCA/USPS-T1-25(a)–(c).

- a. Please confirm that 100 percent of the incremental volume estimated for Years 1, 2, and 3 of the Washington Mutual NSA will be converted from Standard Mail to First-Class Mail. If you do not confirm, please explain.
- b. Because 100 percent of Washington Mutual's incremental volume is derived from Standard Mail, please confirm that for purposes of estimating Q_0 , the own-price elasticity for First-Class Mail is irrelevant; i.e., the elasticity equals 0. If you do not confirm, please explain.
- c. Assuming the own-price elasticity for First-Class Mail is 0, the equation in your response should be written as follows:

$$Q_0 = Q_1 \cdot 1 \cdot \left(\frac{d_0}{d_d} \right)^{E_d} \quad \text{Equation 1}$$

If you do not confirm, please explain.

- d. Assuming the own-price elasticity for First-Class Mail is 0, please confirm that the "discount elasticity," E_d , the only unknown, can then be solved as follows:

$$\ln Q_0 = \ln Q_1 + E_d \cdot \ln \left(\frac{d_0}{d_d} \right) \quad \text{Equation 2}$$

$$E_d = -0.8538$$

If you do not confirm, please explain, show all calculations, and provide citations to all sources used.

- e. Please confirm that this "discount elasticity," E_d , can only be derived from the point volume estimates and average revenue specific to the Washington Mutual NSA, and therefore serves only to validate the point volume estimates that are inherent in the NSA as negotiated. If you do not confirm, please explain.
- f. Please confirm that this "discount elasticity," E_d , does not represent an independent, *a priori* estimate of Washington Mutual's elasticity of demand for Standard Mail with respect to a change in price of First-Class Mail. If you do not confirm, please explain.
- g. Please confirm that this "discount elasticity," E_d , includes exogenous factors that would affect Washington Mutual's volume response and, therefore, does not "assure that the additional mail volume is caused by the incentive to mail additional volume (because of the mailer's demand characteristics), and not because of exogenous factors." See PRC Op. MC2004-3, para. 3006, Opinion and Further Recommended Decision. If you don't confirm, please explain.
- h. Assuming the own-price elasticity for Washington Mutual's First-Class Mail is 0, please provide the "discount elasticity," E_d , that excludes exogenous factors that would affect Washington Mutual's volume response.
- i. Please provide a definition for "cross-price" elasticity, and give a citation to the source for your definition. Please compare and contrast your "discount elasticity" to the definition you cite.
- j. Please confirm that d_0 , the "before rates average marginal discount between First-Class Mail and Standard Mail," of \$0.12 represents the difference between Washington Mutual's First-Class marketing mail average revenue per piece of

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\$0.324 and its Standard Mail average revenue per piece of \$0.204. If you do not confirm, please explain.

RESPONSE:

- a. As noted in my testimony (at page 25, lines 16–17), I assumed that 100 percent of the growth in First-Class Mail resulted from conversion of Standard Mail for the purposes of estimating the financial value of the NSA.
- b. Although I assumed 100 percent of the growth in First-Class Mail resulted from conversion of Standard Mail for the purposes of estimating the financial value of the NSA, as stated in my response to part (a), it is highly unlikely that Washington Mutual's First-Class Mail volume has an own-price elasticity of demand equaling zero. See my response to OCA/USPS-T1-30.
- c. Confirmed that, if Washington Mutual's First-Class Mail volume had an own-price elasticity of demand equaling zero, the equation as written would apply.
- d. Confirmed that, if Washington Mutual's First-Class Mail volume had an own-price elasticity of demand equaling zero, the given equation could be solved as stated, within rounding.
- e. Confirmed, assuming that the question is asking if Washington Mutual's revealed preferences need to be taken into account when calculating their firm-specific elasticities.
- f. Confirmed, assuming that the question is asking if Washington Mutual's revealed preferences were taken into account when calculating this firm-specific elasticity.
- g. Not confirmed. Since the marginal price of Washington Mutual's First-Class Mail volume is the only change between the before-rates and after-rates scenarios presented, it seems safe to assume that "the additional volume is caused by the incentive to mail additional volume."
- h. Assuming that Washington Mutual's First-Class Mail volume had an own-price elasticity of demand equaling zero, the discount elasticity would be that posited in the equation in part (d) of this interrogatory.
- i. Cross-price elasticities, also called a cross elasticities of demand, "measure the percentage increase or decrease in the demand for a good in response to

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changes in the prices of other goods." (Samuelson and Nordhaus, *Economics*, 13th ed., 1989, p. 429) Discount elasticities measure the percentage increase or decrease in the demand for a good in response to changes in differences between the price of that good and the prices of other goods. For more discussion of discount elasticities and their use in Postal Service demand modeling, see the testimony of Witness Thress (USPS-T-7) in R2006-1.

- j. Confirmed, within rounding, that d_0 represents the difference between Washington Mutual's before-rates First-Class Mail marketing volume average revenue per piece and its Standard Mail average revenue per piece.

OCA/USPS-T1-30. This interrogatory seeks information on the price elasticity for Washington Mutual Bank (WMB). Please refer to your response to OCA/USPS-T1-26. Please provide the different own-price elasticities for Washington Mutual's First-Class Mail used for acquisition, billing, and customer communications.

RESPONSE:

I have not computed own-price elasticities for the various types of mail Washington Mutual sends, but some inferences about their relative magnitudes can be made.

Billing mail has a very low own-price elasticity because of its non-discretionary nature, and because of content restrictions that require bills to be sent via First-Class Mail. Although customers can opt to receive their bills electronically, Washington Mutual does not provide an incentive to switch to electronic bill presentment, nor a disincentive to abandon mailed bills. As a result, the decision to receive bills through the mail is made by Washington Mutual's customers, in whose decision the price of postage receives little weight, presumably.

Because it also contains personal information, customer communications mail is also restricted to First-Class Mail. However, the own-price elasticity of this mail should be somewhat higher (in absolute value) than that of billing mail, because Washington Mutual has more discretion over how to disseminate this information. For instance, customer communication could be included in a bill or statement instead of being sent separately, or it could be delivered via telephone or e-mail in some cases.

In contrast to billing and customer communication mail, Washington Mutual has easy access to an alternative method for sending acquisition mail (Standard Mail), as well as marketing alternatives that bypass the mail stream entirely. Therefore, one would expect Washington Mutual's First-Class Mail acquisition volume to be more price-sensitive than billing or customer communication volume.

OCA/USPS-T1-31. This interrogatory seeks information on the price elasticity for Washington Mutual Bank (WMB). Please refer to your response to OCA/USPS-T1-27. Also, please refer to Appendix A of your testimony.

- a. Refer to your response where it states, "In the WMB NSA, such a migration [between rate categories or subclasses] is an important part of the deal,...." With respect to Washington Mutual's incremental volume, please confirm that the migration of Standard Mail to First-Class Mail is the only relevant volume the Postal Service is willing to measure. If you do not confirm, please explain and quantify any other additional incremental volume to be generated by Washington Mutual, and identify its origin.
- b. Refer to Equation 2 in your response. Please confirm that the portion of Equation 2 that "eliminates the 'double counting' of contribution from Standard Mail that is converted to First-Class Mail," referred to as the "additional element," should be written as follows: $-(p_s - c_s) \times (Q_{s0} - Q_{s1})$. If you do not confirm, please explain.
- c. Refer to the "additional element," $-(p_s - c_s) \times (Q_{s0} - Q_{s1})$, in your response, and Appendix A of your testimony. Please show in Appendix A where you eliminate the "double counting" of contribution from Standard Mail that is converted to First-Class Mail for the Washington Mutual NSA.
- d. Refer to Appendix A, worksheet tab "USPS value," which gives the Year 1 Contribution from New Volume for Marketing Mail Letter – Converted Volume from Standard Mail of \$28,099,973. Please confirm that the \$28,099,973 in contribution has not eliminated all the "double counting" of contribution from Standard Mail that is converted to First-Class Mail (*i.e.*, with respect to the 51 million Standard Mail pieces discussed below). If you do not confirm, please explain, show all calculations, and provide citations to all sources used.
- e. Refer to Appendix A, worksheet tab "USPS value," which gives the Year 1 Contribution from New Volume for Marketing Mail Letter – Converted Volume from Standard Mail of \$28,099,973. Please confirm that the \$28,099,973 in contribution is based upon 263 million (593 million – 330 million) Standard Mail pieces converting to First-Class Mail. If you do not confirm, please explain, show all calculations, and provide citations to all sources used.
- f. Refer to Appendix A, worksheet tab "USPS value," which gives the Year 1 Contribution from New Volume for Marketing Mail Letter - Converted Volume from Standard Mail of \$28,099,973. Please confirm that the \$28,099,973 in contribution does not take into account the reduction in Standard Mail contribution from the loss of 51 million (314 million – 263 million) pieces of Standard Mail in Year 1 (After Rates). If you do not confirm, please explain, show all calculations, and provide citations to all sources used.

RESPONSE

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- a. The agreement with Washington Mutual is designed to induce conversion of marketing mail from Standard Mail to First-Class Mail. For the purpose of

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presenting a representative and easily understood analysis, my worksheet assumes that all of the First-Class Mail “produced” by the Washington Mutual NSA will have been converted from Standard Mail. In reality it is unlikely – and beyond incontrovertible proof – that there will not be other effects. For instance, with a lower marginal price for First-Class Mail letters, I fully expect that Washington Mutual will send some First-Class Mail that would not have otherwise been sent as Standard Mail. On the other hand, our agreement allows for Washington Mutual to send some Standard Mail, despite the fact that Washington Mutual’s expressed intent is to convert their marketing programs to First-Class Mail. The reasons for this are relatively straightforward; if Washington Mutual were to identify customer acquisition opportunities that were profitable using Standard Mail, but that were not at the still higher NSA First-Class Mail prices, it would be imprudent and ultimately detrimental to the interests of all postal customers to forestall such opportunities, thus my worksheets contain an assumption that Standard Mail will continue to be used up to the levels allowed by the contract. I would point out that these worksheets have been provided in electronic form so as to allow substitution of a wide range of alternative assumptions that would, of course, produce slightly different results.

- b Confirmed.
- c In my appendix, I did not attempt to conduct the Panzar test.
- d-f. Please see my response to part a.

OCA/USPS-T1-32. This interrogatory seeks information on the price elasticity for Washington Mutual Bank (WMB). Please refer to your testimony at page 17-24, "C. USPS Analysis of WMB Before Rates Forecast," and the Request, Attachment F, which reproduces the original Negotiated Service Agreement Between United States Postal Service and Washington Mutual Bank (herein "original NSA").

- a. At any point prior to the signing of the original NSA on March 16, 2006, did the Postal Service request from WMB an estimate of WMB's own-price elasticity of demand for First-Class acquisition, billing, or customer communications mail, or a weighted-average thereof? Please explain.
- b. At any point prior to the signing of the original NSA on March 16, 2006, did the WMB provide an estimate of WMB's own-price elasticity of demand for First-Class acquisition, billing, or customer communications mail, or a weighted-average thereof? Please explain. If yes, provide the own-price elasticity of demand.
- c. At any point prior to the signing of the original NSA on March 16, 2006, did the Postal Service estimate an own-price elasticity of demand for WMB's First-Class acquisition, billing, or customer communications mail, or a weighted-average thereof? Please explain. If yes, provide the own-price elasticity of demand.

RESPONSE:

- a. No. Based on past experience, the Postal Service does not expect mailers to have calculated, econometrically or otherwise, the own-price elasticity of their mail volume, either for the whole or for any particular subset.
- b. No.
- c. No. While the Postal Service performed analysis of WMB's volumes, none of this analysis led to a useful estimate of the own-price elasticity of WMB's volume.

OCA/USPS-T1-33. This interrogatory seeks information on the price elasticity for Washington Mutual Bank (WMB). Please refer to your testimony at page 17-24, "C. USPS Analysis of WMB Before Rates Forecast," and the Request, Attachment F, which reproduces the original Negotiated Service Agreement Between United States Postal Service and Washington Mutual Bank (herein "original NSA").

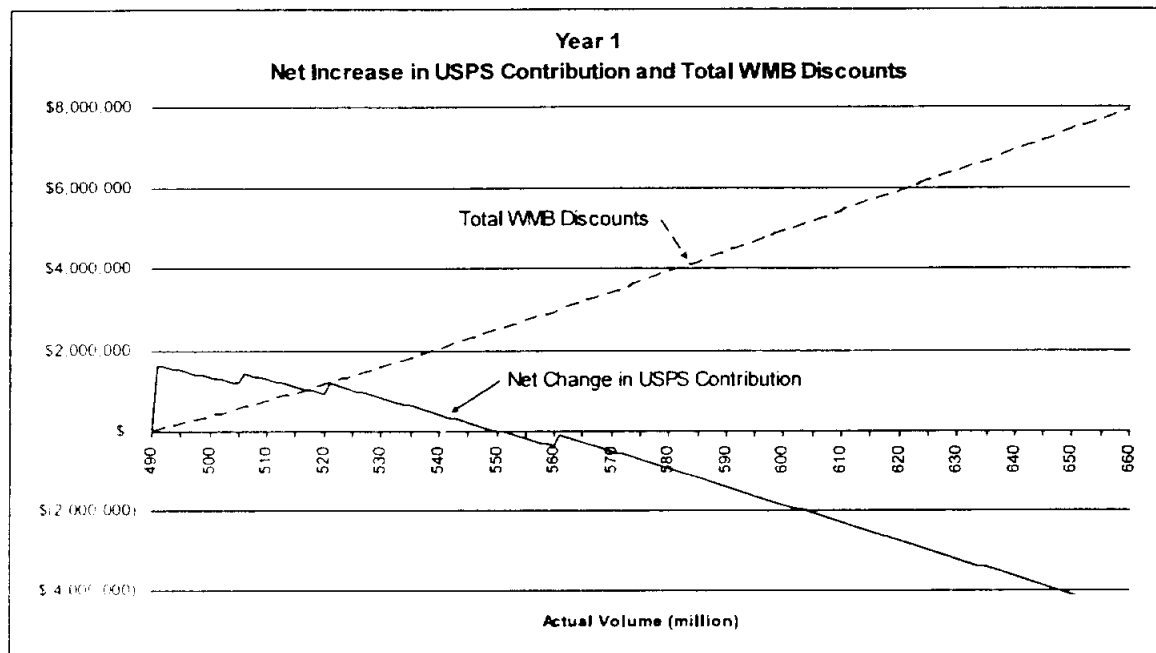
- a. At any point prior to the signing of the original NSA on March 16, 2006, did the Postal Service request from WMB an estimate of WMB's cross-price elasticity of demand for Standard Mail with respect to a change in price of First-Class Mail? Please explain.
- b. At any point prior to the signing of the original NSA on March 16, 2006, did the WMB provide an estimate of WMB's cross-price elasticity of demand for Standard Mail with respect to a change in price of First-Class Mail? Please explain. If yes, provide the cross-price elasticity of demand.
- c. At any point prior to the signing of the original NSA on March 16, 2006, did the Postal Service estimate WMB's cross-price elasticity of demand for Standard Mail with respect to a change in price of First-Class Mail? Please explain. If yes, provide the cross-price elasticity of demand.

RESPONSE:

- a. No. Based on past experience, the Postal Service does not expect mailers to have calculated, econometrically or otherwise, the cross-price elasticity of their mail volume, either for the whole or for any particular subset.
- b. No
- c. No. While the Postal Service performed analysis of WMB's volumes, none of this analysis led to a useful estimate of the cross-price elasticity of WMB's volume.

RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS AYUB TO INTERROGATORY OF THE OCA

OCA/USPS-T1-34. This interrogatory seeks information that could be used to reduce financial risk to the Postal Service from the Washington Mutual Bank (WMB) NSA. Please refer to your testimony, Appendix A, the following charts entitled "Net Increase in USPS Contribution and Total WMB Discounts" for Years 1, 2, and 3 of the WMB NSA [sic], and the accompanying electronic Excel file "OCA Exh2_Panzar Test-WMB." In Year 1, for volumes up to 551 million, please confirm that the Postal Service will not lose First-Class Mail contribution under the WMB NSA, according to the Panzar test. If you do not confirm, please explain, and show all calculations and all sources used.



RESPONSE:

In answering this interrogatory, I am assuming that the 'FC Wksh Cross-Price Elasticity' in the attached worksheet refers to Witness Thress' Average Standard Regular Letters Discount (Relative to First Class) elasticity

Please also note that at 490 million pieces, the net increase in USPS contribution is \$25,000. See paragraph IIIJ of the Negotiated Service Agreement between the United States Postal Service and Washington Mutual Bank.

The chart above is true if the following conditions are met:

1. The own-price elasticity of WMB's First-Class Mail is zero;
2. The discount elasticity of WMB's First-Class Mail (relative to Standard Mail) is equal to the system-wide average of -0.115 ;

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS AYUB TO
INTERROGATORY OF THE OCA**

OCA/USPS-T1-34 Continued

3. The discount elasticity and volume as a proportion of total marketing mail of WMB's Standard Mail conform to the following limits:

WMB After-rates First-Class Mail Volume	Minimum Standard Mail Discount Elasticity	Maximum Before-rates Standard Mail proportion
490,000,001–505,000,000	0.869	12.8%
505,000,001–520,000,000	0.851	13.3
520,000,001–560,000,000	0.832	13.8
560,000,001+	0.814	14.3

In other cases, not confirmed.

Also, it seems inappropriate to perform a Panzar analysis using a systemwide average cross-price elasticity (rather than a cross-price elasticity calculated from WMB data) and an own-price elasticity of zero, apparently based upon WMB's testimony. Consistently using systemwide elasticities or WMB elasticities would result in a higher estimate of the volume above which USPS would lose First-Class Mail contribution under the Panzar analysis

**RESPONSE OF UNITED STATES POSTAL SERVICE WITNESS AYUB TO
INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.,
AND VALPAK DEALERS' ASSOCIATION, INC.**

VP/USPS-T1-1. Please refer to your testimony at page 3, lines 18-21.

- a. At the time the Postal Service filed Docket No. MC2002-2, the Capital One Services, Inc. NSA, did the Postal Service then view the cost savings mechanism contained in that NSA as an integral part of that NSA?
- b. If your response to preceding part a is affirmative, does the Postal Service continue to regard the cost savings mechanism as an integral part of the Capital One NSA?
- c. If your answer to preceding part a is not an unqualified affirmative, please explain the Postal Service's current position with respect to the cost savings mechanism contained in the Capital One NSA.
- d. Is this the first NSA in which the Postal Service has concluded that "additional worksharing on the mailer's part is not a necessary element of a successful NSA" (ll. 20-21)? If not, please explain when the Postal Service reached the decision that all savings elements could be completely decoupled from NSAs with declining block discounts.
- e. If "additional worksharing on the mailer's part" is not necessary, what was the rationale for including it in the NSA with Washington Mutual Bank ("WMB")?

VP/USPS-T1-1 Response

- a. Yes.
- b. Yes.
- c. N/A
- d. The Bookspan NSA (Docket No. MC2005-3) does not contain a cost savings component and employs declining block rates.
- e. The Postal Service considers utilization of ACS by First-Class Mail customers – particularly those that employ First-Class Mail as an advertising medium to be advantageous for a number of reasons and elected to incorporate that requirement in the WMB contract. In a similar vein, the Capital One requirement specifies that Capital One will maintain and expand its commitment to MPTQM despite the fact that the benefits of doing so were not quantified or considered to be "integral" in the sense implied here.

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AND VALPAK DEALERS' ASSOCIATION, INC.**

VP/USPS-T1-2.

Please refer to your testimony at page 3, lines 15-18, and lines 21-22, where you discuss the Postal Service's desire to use NSAs to achieve additional volume and contribution to institutional cost.

- a. When the declining block discount for First-Class Mail serves only to convert existing Standard Mail to First-Class status, would you agree that net new volume of mail (i.e., First-Class Mail and Standard combined) is not a consideration in the evaluation of that NSA? If not, please explain why not.
- b. When the mailer that is party to the NSA, WMB in this case, in fact reduces its total combined volume of Standard and First-Class Mail, would you agree that in such a circumstance the NSA involves a trade-off between change in volume and contribution to institutional cost? That is, would you agree that in order for the Postal Service to obtain the increased contribution to institutional cost, it will realize a reduction in the total volume of mail entered by the mailer? Please explain any disagreement.
- c. Under circumstances such as that discussed here, are not references to "additional volume" somewhat academic and irrelevant? If not, please explain why not.

VP/USPS-T1-2 Response

- a. The scenario in the question is confirmed, but I note that in this case, we do not project an absolute increase in the number of total pieces.
- b. I would generally not describe this effect as a trade off as the term implies an intentional exchange. I would describe the reduction in Standard Mail as a byproduct of the intended result of the NSA: an increase in First-Class Mail sent by WMB.
- c. No. That particular section of the testimony refers – in a general sense – to the Postal Service's policy position on NSAs and not to the particular features of any one contract. In that regard, the reference is anything but "academic and irrelevant".

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INTERROGATORIES OF VALPAK DIRECT MARKETING SYSTEMS, INC.,
AND VALPAK DEALERS' ASSOCIATION, INC.**

VP/USPS-T1-4.

At page 4, lines 3-8, of your testimony, you discuss using NSAs as a tool to convert Standard Mail to First-Class, thereby increasing "the proportion of relatively high contribution First-Class Mail volume..." (l. 9).

a. Is it the Postal Service's intention to use NSAs to create within First-Class Mail a de facto subclass of First-Class bulk solicitation mail limited to a few mailers?

Please explain any negative answer.

b. Even if it is not the Postal Service's design or intention to create within First-Class Mail a de facto subclass of First-Class bulk solicitation mail limited to a few mailers, will not that be the effective result of this NSA, along with the Capital One, Bank One, Discover, and HSBC NSAs? Please explain any negative answer.

c. Instead of using a mailer-by-mailer approach to creation of such a subclass, would not it be more fair and more sensible for the Postal Service to file a request to create a bulk solicitation subclass within First-Class Mail? Unless you agree, please explain why not.

d. Why is a series of NSAs, each of which is exclusive to an individual mailer, and which may exclude many similarly-situated mailers, more fair and superior to a niche classification or a new First-Class bulk solicitation subclass?

e. Please explain fully all reasons why the three conditions on page 12, lines 6-8, of your testimony could not be incorporated into a set of requisite conditions for either a niche classification or a new First-Class bulk solicitation subclass.

VP/USPS-T1-4 Response

a. No. The Postal Service has not considered whether the different demand characteristics associated with First-Class Mail advertising are sufficient to warrant separate subclass treatment.

b. See response to part a. Moreover, I do not agree that NSAs have to be "limited" to a few mailers; the functional equivalency provisions of the Commission's rules enable similarly situated mailers to participate in NSAs once a baseline is established. In my opinion, the high transaction costs associated with bringing NSA cases to the Commission serve as a barrier to prevent widespread usage among mailers for NSAs.

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- c. The Postal Service and WMB have negotiated a contract that includes a number of safeguards designed to ensure that the incentives achieve the intended result. These safeguards would be more difficult to standardize in a subclass. For instance, the contract with WMB (as with all of the other NSAs) prohibits WMB from using its incentives to mail on behalf of other customers. This is intended to ensure that the NSA does not serve to breed consolidation and the inadvertent payment of incentives for mail that merely is transferred from one company to another.
- d. The purpose of my testimony is to establish that the Washington Mutual NSA conforms to the pricing and classification criteria of the Act, and to quantify the expected financial results of the contract. I did not attempt to evaluate the relative superiority of the NSA relative to alternative approaches. Moreover, similarly situated customers are able to avail themselves of functionally equivalent agreements if they choose to, and thus are not excluded.
- e. I have not attempted to identify all of the conditions that would have to exist to support the creation of a niche classification as herein described. Nor have I attempted to design prices for a subclass of this kind. I would point out that for the most part, prices in all other subclasses are uniform with respect to quantity.

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VP/USPS-T1-5.

Your testimony at page 4, lines 6-8, points out that the contribution of First-Class Mail is relatively high in comparison to the contribution of Standard Mail.

- a. Would you agree that the effect of the block discounts for First-Class Mail contained in the NSA is to reduce, but not equalize, the difference in contribution? If you do not agree, please explain why not.
- b. Would you agree that, within the context of an NSA, a discount for First-Class Mail is the only way to narrow the difference in contribution between First-Class Mail and Standard Mail? If you do not agree, please indicate other ways of which you are aware that the Postal Service, as a practical matter, could narrow the difference in contribution between First-Class Mail and Standard Mail in an NSA.
- c. Would you agree that within the context of an omnibus rate case the difference in contribution also could be narrowed by increasing the contribution on Standard Mail relative to the contribution on First-Class Mail? If you do not agree, please explain why not.

VP/USPS-T1-5 Response

- a. Yes
- b. No, I would not. For instance, a customer may be willing to pay a premium over existing Standard Mail rates that would have the same effect.
- c. All other things being equal, the hypothetical approach contained in this question would have the effect described.

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VP/USPS-T1-6.

At page 5, line 23, of your testimony, you refer to "functionally equivalent" mailers.

- a. Could any user of Standard Mail potentially be a "functionally equivalent" mailer? Please explain why or why not.
- b. Could any Standard mailer that enters letter-shaped mail potentially be a functionally equivalent mailer? Please explain why or why not.
- c. Unless your answer to preceding parts a or b is affirmative, please explain what distinguishes Washington Mutual Bank from other Standard mailers — at least those with volumes at least equal to those of WMB.

VP/USPS-T1-6 Response.

a-c. Theoretically, any Standard Mail customer willing to accept the same terms as WMB might be functionally equivalent. I am not aware of Standard Mail customers that have come forward to do so, however.

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VP/USPS-T1-7.

At page 7, lines 6-11, you discuss the address correction element contained in the WMB agreement. Also, at page 11, lines 11-13, you discuss Postal Service benefits from replacing the physical return of First-Class Mail with electronic notice.

- a. Does the Postal Service have any plans to equalize the rates charged to all users of discounted First-Class Mail for electronic address correction and physical return of Undeliverable as Addressed ("UAA") pieces?
- b. Please explain why the Postal Service relies solely on NSAs to obtain the benefits of replacing physical return with electronic notice.

VP/USPS-T1-7 Response

a-b. Please refer to the testimony of Drew Mitchum (R2006-1, USPS-T-40, p.6)

which addresses the Postal Service's proposed revision to ACS pricing.

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VP/USPS-T1-8.

At page 32, lines 17-18, you refer to "any similarly situated company." Please explain all characteristics of those companies that you believe to be similarly situated.

VP/USPS-T1-8 Response

In general, similarly situated companies would be those who currently send Standard Mail advertising and who may be interested in switching their volumes to First-Class Mail with appropriate rate incentives.

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OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-9.

- a. Please confirm that your USPS-T-1, Appendix A, page 1, assumes that the average return rate for all First-Class Mail is 1.23 percent. If you do not confirm, please provide the correct figure.
- b. Please define "return rate" as you use that term in your Appendix A. In particular, explain whether the return rate refers to all undeliverable as addressed ("UAA") mail, or only that portion of UAA mail that is returned (electronically or physically) because it cannot be forwarded.
- c. If the average "return rate" for First-Class Mail is 1.23 percent, what is the percentage of First-Class Mail that also is UAA, but is forwarded to addressees instead of being returned?
- d. Please confirm that, for WMB's solicitation mail, the return rate assumed in your Appendix A, pages 5 and 6, is 4.5 percent. If you do not confirm, please provide the correct figure.
- e. Please provide the source of the 4.5 percent return rate for WMB mail shown in your Appendix A, pages 5 and 6, and explain whether the percentage is based on actual returns of First-Class solicitation mail or Standard solicitation mail sent by WBM (including its predecessor, Providian). If the return rate is based on experience with Standard solicitation mailings, please explain its derivation, since Standard mail normally is not returned.
- f. If the return rate for WMB mail shown in your Appendix A, pages 5 and 6, refers only to that portion of WMB's UAA mail that must be returned because it cannot be forwarded, what is the estimated percentage of WMB's solicitation mail that is UAA — *i.e.*, mail that is UAA and is forwarded, as well as returned (electronically or physically) when it cannot be forwarded?

RESPONSE:

- a. The average return rate for all First-Class Mail is 1.23 percent.

However, in the updated Appendix A, which includes data from Docket No. R2006-1, the return rate used is 1.70 percent, which corresponds to the UAA rate for automation and presort First-Class Mail.
- b. It refers to the all volume that is returned to sender because it is UAA.
- c. Please see Witness Sam Cutting's testimony in Docket No. R2006-1, specifically, LR-L-62 and LR-L-61.

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- d. The 4.5 percent rate is used only for First-Class Mail marketing purposes. The 1.0 percent rate is used for First-Class Mail operational pieces.
- e. It is based on historical data provided by WMB on their First-Class mail marketing volume.
- f. We do not have an estimate of WMB's UAA volume that is forwarded.

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VP/USPS-T1-10.

- a. With respect to FY 2005, what is the Postal Service's estimate of (i) the total volume of First-Class UAA mail, and (ii) the total cost of handling such UAA mail?
- b. For all First-Class Mail in FY2005, what is the ratio of the volume of UAA mail forwarded to the volume returned?
- c. In FY 2005, what was the unit cost to:
 - (i) forward a piece of UAA mail?
 - (ii) physically return a piece of UAA mail?
 - (iii) supply the sender with an electronic address correction for a piece of UAA mail?

RESPONSE:

(a-c) Please see Witness Sam Cutting's testimony in R2006-1, specifically, LR-L-62 and LR-L-61.

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VP/USPS-T1-11.

- a. Please confirm that one goal of the Postal Service's Strategic Transformation Plan 2006-2010 (September 2005) is to reduce the volume of UAA mail, and confirm that goal is stated in the Transformation Plan at p. 59. If you cannot confirm, please explain.
- b. Are you aware that Postmaster General Potter reiterated the importance of the Transformation Plan goal to reduce the volume of UAA mail in his keynote address to the National Postal Forum in Orlando, Florida, April 3, 2006?
- c. Please state whether you agree with the PMG Potter's assessment of the importance of the Transformation Plan goal to reduce the volume of UAA mail.
- d. When negotiating NSAs that encourage the conversion of Standard Mail to First-Class Mail, what consideration, if any, do you give to the goal of reducing the volume of UAA mail when the mailing lists used for such solicitation mail are known to contain percentages of UAA mail that far exceed the average in First-Class?

RESPONSE:

- a. Confirmed.
- b. Confirmed.
- c. I agree with this principle, and also believe it is important for the Postal Service to grow revenue and manage its cost structure efficiently.
- d. The NSA encourages the conversion of mail that results in a higher overall net contribution to the Postal Service. We balanced against the risk of higher UAA costs, however, by including provisions in the NSA to reduce the amount of UAA mail. Furthermore, NSAs of this type have been helpful in lowering the UAA rate of our ACS customers, which benefits both Standard Mail and First-Class Mail. It is never the intent of any customer to send mail that is incorrectly addressed and which will create little or no value for the customer. Moreover, the additional address hygiene requirements of the NSA aid in lowering the UAA rate.

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VP/USPS-T1-12.

Please explain how giving discounts to encourage conversion of Standard solicitation mail with a relatively high percentage of UAA mail (*i.e.*, "dirty" mail) to First-Class Mail furthers the Transformation Plan's goal of reducing the volume of UAA mail in the First-Class mailstream.

RESPONSE:

The Postal Service does not consider UAA Standard Mail solicitation to be "dirty" mail.

As discussed in my response to VP/USPS-T1-11, WMB will be taking steps to decrease the risk of UAA mail by utilizing electronic ACS and updating their address lists.

Moreover, the NSA increases the overall contribution to the Postal Service by encouraging the conversion of Standard Mail to more profitable First-Class Mail, which benefits all customers of the Postal Service.

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VP/USPS-T1-13.

- a. *Would you agree that the benefits to the Postal Service from the proposed NSA with WMB are attributable almost entirely to the volume of Standard Mail that converts to First-Class Mail in response to the declining block discounts? If you do not agree, please explain fully.*
- b. *Would you agree that the volume of Standard solicitation mail that WMB converts to First-Class in response to the declining block discounts are a reflection of WMB's cross-elasticity of demand between Standard and First-Class? If you do not agree, please explain fully.*

RESPONSE:

- a. The benefits, as quantified in the filing, are largely attributed to the conversion of Standard Mail solicitations to First-Class Mail. However, the additional benefits are that the NSA:
 - i. lowers the UAA rate on current First-Class Mail solicitations, thereby increasing the amount of net contribution from this mail;
 - ii. encourages new First-Class Mail volume that is not converted from Standard Mail;
 - iii. increases visibility of First-Class Mail as an acquisition medium; and
 - iv. increases contribution of existing First-Class Mail pieces by converting current UAA mail to electronic returns.
- b. The volume of Standard Mail solicitation that WMB converts to First-Class Mail in response to the declining block discounts could be used as a proxy for the cross-price elasticity of demand between First-Class Mail marketing and Standard Mail. However, this would assume that all Standard Mail pieces and current First-Class Mail pieces are exactly

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the same in terms of the expected value of the prospective customer
and other profitability variables.

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OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-14.

Please refer to your testimony at page 20, lines 8-9, where you state that “the quality of a credit card company’s mailing list highly correlates with the class of mail chosen for marketing.”

- a. Please define, or describe more completely, what you mean by the expression “quality of a ... mailing list,” as you use that expression in this part of your testimony. In particular, please distinguish between “quality” as it might relate to (i) the percentage of positive responses expected to be received from the mailing, (ii) the number of pieces in the mailing that are expected to be UAA, and (iii) any other aspects of quality you care to include in your response.
- b. When a credit card company — e.g., one such as WMB — uses a list for a solicitation, how does it determine *a priori* the “quality” of the list? Does it test a segment of the list?
- c. Does your above-cited statement mean that a credit card company somehow determines the quality of a list and then knowingly assigns “low-quality” lists to be entered as Standard Mail, while assigning “high-quality” lists to be entered as First-Class Mail? Regardless of whether your answer is affirmative or negative, please elaborate on what you intend by the above-cited statement regarding the correlation between quality of a mailing list and the class of mail chosen for marketing.

RESPONSE:

- a. The quality of mailing lists, as I describe in my testimony, is meant to include the value of a prospective customer and also an estimate of response rates, which impacts the value calculation. The factors that influence the calculation of the value of a prospective customer can include demographic and economic factors, such as income and credit scores. The estimate of response rate also varies based on certain factors, such as the source of the list and the demographics of the prospective customers.
- b. It is my understanding that card issuers consider a variety of factors when attempting to calculate the value of a list. The factors are similar to those identified in my response to Part (a) of this interrogatory.

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- c. Not necessarily; as indicated above, the "quality" of a list is closely tied to the value of a prospective customer, and response rates. The decision between choosing either First-Class Mail or Standard Mail comes down to a cost-benefit analysis of the response rate and cost differential between the two classes of mail. If the response rate of a targeted list is the same between First-Class Mail and Standard Mail, in all probability the marketer will use Standard Mail as the preferred acquisition medium. But if First-Class Mail has a higher response rate, then the expected value is compared to the increased cost of First-Class Mail, and the marketer must decide if the higher investment in First-Class Mail is justified by the higher expected value.

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ASSOCIATION, INC.**

VP/USPS-T1-15.

Please refer to your testimony beginning at page 21, line 13, and extending to page 22, line 10. In particular, please refer to your statements that (i) historically, Providian focused on "higher risk and generally underserved customers who might not ordinarily qualify for credit cards, including customers with past credit card problems or limited credit history," (ii) the company has stated that it is "currently refocusing our business on the middle and prime market segments," and (iii) the statement that First-Class Mail was used to solicit accounts from customers who were known to be high-risk and to have had past credit card problems, while solicitation of potential customers in "the middle and prime market segments" makes improbable "any large-scale migration back to First-Class Mail as a marketing channel."

- a. Please state your understanding of why First-Class Mail would be the marketing medium of choice for potential customers are known to be high risk, either by virtue of past credit card problems, or for any other reason.
- b. Please state your understanding of why Standard Mail would be the marketing medium of choice for potential customers who are considered to fall in the middle of prime market segments. In particular, what are the primary factors that make Standard Mail the marketing medium of choice for this more upscale market segment, and why is an NSA with declining block discounts a necessary and desirable way to overcome the factors that make Standard Mail the preferred medium?

RESPONSE:

- a. It is our understanding from previous NSA discussions and research that the targeted lists for potential customers who are assumed to be high risk generally have higher response rates to First-Class Mail. The factors that influence the higher response rates vary across issuers. The variables could include: pricing of the card, fee structure, credit limits, address sources, and other demographics.
- b. The middle-markets for issuers like WMB primarily are customers who have established relationships with the issuer or one of their competitors. It is our understanding that for this segment of the market, the cost-benefit analysis for WMB is that Standard Mail is a preferred

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medium even though First-Class Mail may have a higher response rate.

This is because the cost of First-Class Mail acquisition is significantly higher than Standard Mail. The NSA is an effective and desirable tool in making First-Class Mail the preferred acquisition medium because we can identify the price-point at which customers will use First-Class Mail over Standard Mail.

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VP/USPS-T1-16.

Please refer to your testimony at page 12, lines 11-12, and page 20, lines 11-12. At page 20, you note that "Card Services will intensify its focus on cross-selling products to other WMB customers," and at page 12 you state that another term and condition beneficial to the Postal Service is that the subject matter of the agreement is limited to WMB's credit card products and credit card services.

- a. Please list all other services of which you are aware that WMB offers to its customers, (e.g., mortgages, home-equity lines of credit, insurance of any kind (life, title, credit, etc.), checking accounts, savings accounts and CDs, mutual funds, stock brokerage services, etc.) that might be "cross-sold" by Card Services to other WMB customers.
- b. For purposes of this proposed NSA, are all of the other services listed in your response to preceding part a considered to be "card products," or "credit card services?" If not, please indicate which items would be considered to fall under either of these two terms, and which would be excluded from falling under either of these two terms.
- c. To what extent does the above-cited limitation mentioned on page 12 (ll. 11-12) of your testimony restrict Card Services from cross-selling WMB products that are not "card products" or "credit card services?" Please give examples of WMB products that could not be cross-sold by solicitation mail entered under this proposed NSA agreement.

RESPONSE:

- a. The NSA agreement only covers mail that is associated with the credit card services. It is my understanding that the card service group does not cross-sell mortgages, home equity, life insurance, and other financial products. They are involved only with credit card offerings, such as balance transfers, new cards, or rewards.
- b. Please see the answer to Part (a).
- c. The cited limitation limits the NSA to credit card mailings, which does not include life insurance and other types of financial products.

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VP/USPS-T1-17.

Please refer to your testimony at page 23, lines 5-6, where you state that "the average response rates for a credit card solicitation fall between 0.3 and 0.4 percent, according to our data sources."

- a. Do your data sources for response rates for credit card solicitations distinguish between the response rates for solicitations sent via First-Class Mail and those sent via Standard Mail?
- b. Please indicate the level of detail about response rates that is available to the Postal Service for its evaluation of volume forecasts by NSA applicants. For example, do your data sources provide you with (i) the range of response rates experienced by various credit card mailers, and/or (ii) one or more measures of dispersion around the average response rate?

RESPONSE:

- a. Our data sources do not distinguish between First-Class Mail and Standard Mail.
- b. The data cannot be broken down by provider or by specific campaign mailings. There are no measures of dispersion around the average response rates.

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OF VALPAK DIRECT MARKETING SYSTEMS, INC., AND VALPAK DEALERS'
ASSOCIATION, INC.**

VP/USPS-T1-18.

Please refer to footnote 11 on page 27 of your testimony, where you (i) discuss the possibility of a rate increase during the term of this agreement, (ii) indicate that such an increase has not been accounted for in the revenue calculations, and (iii) state that ignoring any future revenues from future rate increases may undercount revenues in the out-years, thereby giving greater credence to the conservatism of any assumption.

- a. In light of the Postal Service's filing in Docket No. R2006-1, made on May 3, 2006, would you agree that, during the life of this proposed NSA agreement, at least one omnibus rate increase appears likely? Please explain any disagreement.
- b. When you state that "revenues in the out-years have been undercounted," are you referring to (i) the gross revenues from mail expected to be entered at proposed First-Class rates, (ii) the gross revenues from mail that would have been entered at proposed Standard rates, (iii) the net revenues from WMB's Standard mail that is expected to convert to First-Class, or (iv) the net contribution to Postal Service overhead? Please explain.
- c. Please revise and submit relevant pages of your Appendix A showing the effect on revenues and contribution to overhead under the NSA from rates proposed by the Postal Service in Docket No. R2006-1.
- d. Please explain how the failure to consider the effect of higher rates gives "greater credence ... to the conservatism of any assumption."

RESPONSE:

- a. I am not privy to the decision regarding the next omnibus filing, and in any event, such a decision would have to be made by the Board of Governors.
- b. I am referring to the fact that "gross-revenues" at the time of the filing did not include the proposed increased rates in Docket No. R2006-1.
- c. Please see the revised Appendix A.

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- d. Appendix A assumes that all costs increase on a yearly basis by 4 percent. However, we do not assume any changes in the prices, thereby decreasing the estimated contribution in the out-years.

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VP/USPS-T1-19.

Please refer to your testimony at page 30, lines 8-15, where you discuss the increased costs of UAA mail from converted Standard Mail, and state that those costs are included in the After-Rates First-Class Mail solicitation unit cost estimates.

- a. Did your computations include the cost for forwarding UAA mail that is forwardable?
- b. How many times does WMB send solicitation mail to the same list of addressees? In your response, please distinguish between (i) in-house lists of existing WMB customers, and (ii) rented lists used strictly for solicitation.
- c. When WMB receives electronic address corrections for a list or lists that it no longer intends to use for its own purposes, why should it make any effort to correct such lists? Please explain how correcting a list that WMB no longer intends to use might be expected to add value for the Postal Service, for WMB, or for anyone else.
- d. For WMB solicitation UAA mail that is forwarded, does the proposed NSA agreement provide that the Postal Service will supply WMB with an electronic address correction for such mail? If so, what is the Postal Service's cost to provide each electronic address correction for forwarded mail?
- e. Please explain why the Postal Service agrees to provide free electronic address correction service ("ACS") for mail that is being heavily discounted by the proposed NSA agreement. That is, why does not the Postal Service make any kind of return, whether it be physical return or electronic return, an option which the mailer with declining block discounts could obtain only by paying an appropriate cost-based fee? That is, if the mailer neither cares nor desires to receive any kind of return or electronic address correction, in lieu of the endorsement for electronic ACS, the mailer would indicate "No address correction required."
- f.
 - (i) To what degree does WMB send its solicitation mail to rented lists which are used only once?
 - (ii) Why would WMB want physical return or electronic address correction on those occasions when it makes only a single use of rented lists?
 - (iii) Why would the Postal Service want to expend funds to provide WMB with electronic address correction which would not be used by WMB to improve the quality lists used for mailings?
- g. If WMB currently does not care to purchase electronic return for its solicitations sent as Standard Mail, why would WMB want or need to obtain electronic address correction for its anticipated First-Class Mailings under the NSA?

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RESPONSE:

- a. We did not include either the cost-savings or costs associated with forwards in our calculations. This is consistent with previous NSA filings.
- b. I do not have this level of information.
- c. There is a high probability that addresses are repeated across a variety of lists, and it is highly unlikely that an address will only be targeted once. Furthermore, the card-service groups may use the corrected addresses for other purposes; for example, they may share the corrected addresses with the parent organization.
- d. Under the OneCode environment, this cost is less than \$0.002 per notice.
- e. The incentives in this proposal are not linked to the savings associated with the electronic address correction service. The incentives are used to encourage conversion of Standard Mail to First-Class Mail. The adoption of electronic ACS is an additional requirement that lowers our costs of handling WMB UAA mail volume.
- f.
 - (i) I do not have this information.
 - (ii) WMB total marketing volume is greater than 500 million pieces, and with only 144 million delivery points in FY05, there is a high probability that WMB mailed multiple times to the same delivery point.
 - (iii) There is no evidence to suggest that the data will not be used in future mailings.

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- g. WMB has entered into this mutually beneficial arrangement, and WMB agreed to this provision, which should lower USPS costs and provide WMB with updated address information.

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VP/USPS-T1-20.

Please refer to your response to VP/USPS-T1-2(c). In your response, you refer to the "Postal Service's policy position on NSAs...."

- a. If you have a hard copy statement of the Postal Service's policy position on NSAs, please provide a copy.
- b. If no such hard copy exists, please state and explain the Postal Service's policy position on NSAs. In your response, please explain the policy position with respect to increased volume and increased contribution, as well as any other pertinent factors.
- c. Please assume that an NSA presents the Postal Service with a trade-off in the form of achieving more of one desirable objective and less of another desirable objective, as does the Washington Mutual Bank NSA. What criteria has the Postal Service established, or what criteria does it use, to determine that exceptions to the Postal Service's policy position on NSAs are acceptable, or desirable?

RESPONSE:

- a-b. A formal summary of the Postal Service's policy on NSAs has not been written. In my opinion, the policy is embodied in the Postal Service's filings on NSA cases to date. As indicated throughout all such filings, the Postal Service's position is that NSAs offer an opportunity to test the application of a commonly practiced pricing technique (negotiated pricing) in a unique regulatory setting. In doing so, the Postal Service has committed to testing a range of approaches designed to generate a net gain in contribution as a result of the negotiation. The net gain in contribution could take the form of cost savings, incremental volume growth, or some combination of such factors.
- c. While I do not consider the Washington Mutual presents the kind of trade-off posited by this interrogatory, such a trade-off would conform to the policy – as articulated in my response to parts a & b, if the trade-off produced a net gain in contribution and was otherwise consistent with the pricing and classification criteria established in the Act.

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VP/USPS-T1-21.

Please refer to your response to VP/USPS-T1-4.

- a. In your response to 4(d), you state that "similarly situated customers are able to avail themselves of functionally equivalent agreements if they choose to...." In your response to 4(b), you state that "high transaction costs associated with bringing NSA cases to the Commission serve as a barrier to prevent widespread usage among mailers for NSAs." Please explain how you can concurrently maintain (i) the existence of high barriers to entry and (ii) ready availability of functionally equivalent NSAs to other mailers.
- b. In your response to 4(c), you note that "the contract with WMB (as with all of the other NSAs) prohibits WMB from using its incentives to mail on behalf of other customers."
 - i. Is this provision intended to prevent arbitrage, in the form of preventing mail in a high-cost part of the market from transferring to and taking advantage of a lower-cost market? If not, please explain the necessity for this provision, especially as it pertains to discrimination against other mailers who might want to take advantage of the special discount extended to those who are floored to receive NSAs.
 - ii. Would such a provision be necessary if the Postal Service, in lieu of NSAs, established niche classifications open to all qualified mailers?
- c. In your response to 4(e), you "point out that for the most part, prices in all other subclasses are uniform with respect to quantity." Do you consider prices that are uniform with respect to quantity an undesirable feature of most Postal Service offerings? If so, please explain why you consider uniform prices to be undesirable.

RESPONSE:

- a. The first baseline agreement with Capital One NSA has spawned three functionally equivalent agreements with similarly situated credit card issuers. Arguably, if the Commission had not arbitrarily imposed a cap on incentives, that number might have been larger. Thus, the availability of functionally equivalent NSAs appears to have satisfactorily satisfied similarly situated customers in the only instance for which there is empirical information. However, I have personal experience with a number of customers for whom the potential litigation costs have been an impediment to negotiations.

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- b. i. This provision is intended to ensure that the incentives embodied in the declining block structure work as intended, and to prevent WMB – in this instance – from attaining larger thresholds by acting as a mail consolidator. I am not aware that any floor exists preventing similarly situated customers from seeking similar terms.
- ii. Such a condition would be incompatible with niche classification. However, creation of a niche classification that varied prices based on customer volumes would present other implementation challenges.
- c. I do not consider list prices that do not vary with respect to volume to be inherently undesirable.

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VP/USPS-T1-22.

Please refer to your response to VP/USPS-T1-5(b), where you indicate that "a customer may be willing to pay a premium over existing Standard Mail rates that would have the same effect." Please explain, both in general and with specific examples, what the Postal Service could offer users of Standard Mail that would induce them to pay a premium over existing Standard Mail rates.

RESPONSE:

Hypothetically speaking, the Postal Service could offer Standard Mail with enhancements that cause it to more closely resemble Standard Mail for customers who favored specific characteristics i.e. forwarding, seal against inspection, return of undeliverable mail, and improved service that currently serve to distinguish First-Class Mail from Standard Mail.

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VP/USPS-T1-23.

Please refer to your response to VP/USPS-T1-8.

- a. Please explain whether, in your opinion, it would be reasonable to consider, or think of, the First-Class Mail ("FCM") product as a "brand" of the Postal Service.
- b. Would you agree that the value of the FCM brand would be enhanced by the fact that FCM is regarded by most mail recipients as containing items that are of personal interest to them (e.g., correspondence), or that concern them personally (e.g., bank statements, or statements of account).
- c. Would you agree that most mail recipients generally have lower regard for unsolicited mail than they do for FCM? Please discuss what the Postal Service knows in this regard.
- d. If you succeed in using rate incentives to induce a large volume of Standard Mail advertising to switch to FCM, could the Postal Service run the risk of eroding the esteem for, and cheapening, its FCM brand? If not, please explain why not.

RESPONSE:

- a. Brand being a somewhat vaguely defined concept, First-Class Mail may be thought of as a brand of the Postal Service in that conveys a number of possible associations or attributes.
- b. As I can not confirm the premise embedded in this interrogatory - FCM is regarded by most mail recipients as containing items that are of personal interest to them - I can not agree with this statement.
- c. I can not confirm, and I suspect that measuring the relative levels of regard that recipients have for specific kinds of messages is an imprecise science at best.
- d. I do not believe that changing the indicia of mail pieces that are otherwise identical from the perspective of the recipient will have a meaningful impact on the perceived brand value of First-Class Mail for prospective senders. Moreover, I would point out that in FY 2005 there were more than 98 billion pieces of First-

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Class Mail. It is unlikely that the WBM agreement will have a measurable impact on the perceived brand value of such a massive product.

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VP/USPS-T1-24.

Please refer to your response to VP/USPS-T1-11.

a. In your response to 11(c), you say that you agree with the Postmaster General's goal of reducing the volume of UAA mail. At the same time, you indicate a belief that you consider it important for the Postal Service to grow revenue, even if the means to such revenue growth is encouraging a significant increase in the volume of First-Class UAA mail. Please explain which of these two goals you think is more important.

b. In your response to 11(d), you say that you "reduce[d] the amount of UAA mail" and that "the additional address hygiene requests of the NSA aid in lowering the UAA rate."

i. Please explain the benchmark from which you reduced the amount of UAA mail. Did you reduce it below the average for all FCM? If not, then below what level?

ii. Please explain the benchmark for "lowering the UAA rate...." Did you lower the UAA rate of Washington Mutual Bank's solicitation mail below the rate for all FCM? If not, then below what level?

RESPONSE:

- a. I have not ranked the importance of these two - or of the many other - goals of the Postal Service. However, insofar as this interrogatory implies that the goals are mutually exclusive I would disagree. As I understand the goal attributed to the Postmaster General, he was advocating the reduction of UAA mail in general and not within a specific classification. I would argue that the adoption of electronic ACS by NSA customers will have a profoundly positive effect on the quality of address information used by these customers and will therefore reduce the total quantity of UAA mail, while at the same time growing the revenues of the Postal Service; a true win-win.
- b. My remarks referred to the UAA rate for the NSA customers as compared with rates prior to the agreements. As the Washington Mutual NSA is not yet in effect, there has not been any effect.

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VP/USPS-T1-25.

Please refer to your response to VP/USPS-T1-19. In your response to 19(f), you note that Washington Mutual Bank's total marketing volume exceeds 500 million pieces, and "with only 144 million delivery points in FY 05, there is a high probability that WMB mailed multiple times to the same delivery point."

- a. What is the probability that Washington Mutual Bank reuses and mails to the same third-party list more than one time within a six- to twelve-month period?
- b. If Washington Mutual Bank receives an address correction for someone on rented list A, and that same person also happens to appear on rented lists B and C (and at the same address as on list A), and Washington Mutual Bank subsequently decides to mail to lists B and C, what is the probability that Washington Mutual Bank will use the address correction(s) applicable to list A to correct lists B and C?

RESPONSE:

- a. I do not know the frequency with which Washington Mutual uses the same "third-party list", nor do I believe it is possible to accurately estimate such a frequency with the gross numbers used in this interrogatory.
- b. I do not know Washington Mutual's specific suppression rules for dealing with such instances

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5. Please refer to the Revised Testimony of Michael Rapaport, WMB-T-1, page 3, lines 10-12, where he states that "[b]y 2004, Providian's 'turnaround' was largely successful and the company's new marketing strategy was fully implemented." Given that the marketing restructuring implemented by Providian was completed by 2004, would it be more appropriate to begin an analysis of Before Rates volume trends with the year 2004, rather than include earlier years? If not, why not?

RESPONSE:

No. Although the changes to Washington Mutual's account acquisition studies affected the both the absolute and relative levels of Standard Mail and First-Class Mail advertising that Washington Mutual sent, and therefore need to be taken into account in any analysis of their volume data, there is still valid information about their mailing habits in their historical data. In addition, the Postal Service feels that its analysis should make use of as much valid data as is available.

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6. Please refer to page 8, Table 5 of the Supplemental Testimony of Ali Ayub (USPS-T-1). Please provide the formula, data sources, and data values, used to calculate the value for the cell found at the intersection of "column 680,000,000" and "row 80.00%".

RESPONSE:

The formula is $\text{column head} \times (\text{row stub} \times \text{average FCM price} + (1 - \text{row stub}) \times \text{average Standard Mail price})$, where the average FCM price and the average Standard Mail price are taken from Appendix A of my testimony (sheets "Mktg unit rev" and "SM rev calcs", respectively). The value has been rounded to the nearest million dollars

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7. Article III. D. of the original NSA states that "[i]f by the end of the first year of this Agreement, Washington Mutual mails less than 375 million First-Class mail pieces... Washington Mutual agrees to pay \$250,000." The Amendment to the Negotiated Service Agreement ("Amended NSA") between the United States Postal Service ("USPS") and Washington Mutual Bank ("WMB") has increased the First-Class mail volume thresholds at which WMB would begin to obtain incremental discounts by 50 million first class mail pieces.

- a. Please confirm that the Amended NSA does not adjust the minimum volume of First-Class mail that WMB must mail during the first year of the agreement before being required to pay the Postal Service \$250,000.
- b. If confirmed, please explain if and how the incentives provided by this provision have changed given the revisions to the volume estimates and rate schedule volume block levels.

RESPONSE:

- a. Confirmed
- b. There are no significant changes to the incentives provided by this provision, because both the original and the revised volume history and projections for Washington Mutual indicate a negligible risk that their First-Class Mail volume will fall below this threshold.

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8. This question concerns the appropriateness of the Postal Service's method of calculating the after-rates average marginal price and the after rates average marginal discount in its response to OCA/USPS-T1-25a-c.

- a. Please confirm that the after-rates average marginal price of \$.274 is equal to the marginal price of First-Class mail at the volume tier that receives the \$.05 discount.
- b. Please confirm that the after-rates average marginal discount of \$.07 is equal to the difference between the marginal price of First-Class mail at the volume tier that receives the \$.05 discount and the Standard mail price of \$.204.
- c. Please explain why the after-rates average marginal price and the after rates average marginal discount were not calculated as rates weighted by the volume of mail in each discount tier.

RESPONSE:

- a. Confirmed.
- b. Confirmed
- c. Because the relevant price for these calculations is the price paid by the marginal piece

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REQUEST NO. 2**

QUESTION:

- a. Have the co-proponents considered the impact of the recently issued Bank One and Bookspan Opinions on the Washington Mutual Bank Negotiated Service Agreement Request?
- b. What concerns and issues expressed by the Commission in the Bank One and Bookspan Opinions, including but not limited to the application of the Alternative Model for Negotiating Volume Discounts, have the co-proponents considered?
- c. Of the issues considered in 1(b) above, what were the results of any analysis performed, and what were the conclusions drawn from the analysis?
- d. What modifications have the co-proponents proposed to be made to the Washington Mutual Bank Negotiated Service Agreement Request after consideration of the analysis performed and conclusions drawn as referenced in 1(c) above?

RESPONSE:

- a. Yes, the Postal Service and WMB have discussed the potential impact of the recently issued Bank One and Bookspan opinions on the current NSA. The structure and development of the WMB NSA was completed prior to the recently issued Bank One and Bookspan Opinions. However, the Postal Service relied on Commission rulings in the Bank One filing that were issued prior to the WMB NSA filing.
- b. Both parties gave thoughtful consideration to the Commission's perspectives on caps, the "Panzar" test, mailer-supplied volume data, and the multiplier-effect. After consideration of these issues, however, the parties decided to proceed with the case as filed.
- c. After thoughtful consideration of this issue, the parties decided not to submit a supplemental evidentiary submission applying Dr. Panzar's test ("Panzar

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test"). The parties decided that there were too many open questions raised by that approach, such as how to incorporate cross-price and own price elasticities into the equation. The areas of concern with the Panzar test were addressed in my responses to OCA/USPS-T1-25, -26 and -27. Moreover, the process of calculating the elasticity as described in the Panzar test does not appear to have practical applications in the developing NSAs. For example, the *alternative model provides a basis for evaluating the after-rates response*, but it does not provide guidance on the data needed to support the before-rates forecast. It also does not resolve issues raised by the variability in the before-rates volume. Further, we note that the Commission in its Bank One *reconsideration opinion* did not foreclose other devices to protect against financial harm. In this case, the Postal Service submits that the use of penalties in the NSA with WMB, the termination-at-will clauses, and the high thresholds for the first discount tier provide the Postal Service with the necessary tools it needs to protect its financial best interests.

- d) After thoughtful and careful consideration, the parties decided not to make modifications to the WMB NSA.

1 CHAIRMAN OMAS: Is there any additional
2 written cross-examination for Witness Ayub?

3 THE WITNESS: No, there is not.

4 MR. ALVERNO: Mr. Chairman, could we have
5 just a minute to add those changes and give them to
6 the reporter?

7 CHAIRMAN OMAS: Absolutely.

8 (Pause.)

9 MR. ALVERNO: Thank you, Mr. Chairman.

10 CHAIRMAN OMAS: This brings us to oral
11 cross-examination. The only participant that
12 requested oral cross-examination is Val-Pak Dealers
13 Association, Inc., and Val-Pak Direct Marketing
14 Systems, Inc.

15 Mr. Olson, would you please begin?

16 CROSS-EXAMINATION

17 BY MR. OLSON:

18 Q Thank you, Mr. Chairman. Good morning, Mr.
19 Ayub. I want to ask you to begin by turning to page
20 12 of your testimony, and if you could look at lines
21 18 through 22 where you say that "over time, the
22 Postal Service has learned a considerable amount about
23 the factors that influence demand for mail in the
24 credit card industry. It has developed expertise in
25 this area through its own independent research, its

1 experience with other NSAs, such as the Cap 1 and Bank
2 One agreements, and a multitude of discussions with
3 other banks and financial firms. Do you see that?

4 A Yes, I do.

5 Q Okay. Let me ask -- I was curious --
6 roughly how many discussions have you had that
7 constitute the multitude of discussions with other
8 banks and financial firms?

9 A I cannot quantify that number at this time,
10 but we have met with many of the largest issuers
11 across the industry, and we have met with them
12 multiple times. I don't have a number for you.

13 Q Dozens of different --

14 A I would say more than dozens.

15 Q Based on that experience and study and
16 research, can you tell me when a mailer like WMB takes
17 a solicitation and sends it as first class rather than
18 standard, do you know whether they indicate first
19 class in bold letters, for example, on the carrier
20 envelope or whether they don't say anything about
21 first class and just have the first class indicia on
22 the piece?

23 A We do not make that decision, and I'm not
24 privy to how that decision is made. However, based on
25 the range of customers we've spoken to, some customers

1 may, in fact, identify first class mail on the piece.

2 Q Okay. Just to be clear, I wasn't asking you
3 as to why they would make that decision, just as to
4 whether you knew if a mailer that converted a
5 solicitation from standard mail to first class,
6 whether the normal practice would be to put "first
7 class" in big letters on the carrier.

8 A I do not know that.

9 Q Okay. When a mailer, such as WMB, takes a
10 solicitation and converts it from standard mail to
11 first class, do you know whether they change the
12 substance of the offer that they are making, substance
13 of the solicitation?

14 A Are you referring to the pricing of the card
15 and the customer that they are targeting?

16 Q Well, I'm referring more to the form of the
17 enclosures and the inserts and the letters and such.
18 Is it basically just taking the same package and the
19 same inserts and sending it at first-class rates, or
20 is it a substantial change in the packet?

21 A It's my understanding that it's the same
22 package and the same type of letter that is now
23 mailed, instead of standard mail, mailed through first
24 class.

25 Q The purpose of solicitation mail is to get

1 the addressee to respond, is it not?

2 A That is correct.

3 Q Okay. And as part of that dynamic, I would
4 assume that the first thing you have to do is to get
5 the recipient to open the envelope, and that's a
6 necessary predicate to reviewing the contents.
7 Correct?

8 A That is correct.

9 Q Okay. I wouldn't expect an unopened mailing
10 would get much response, would it?

11 A I have heard it does sometimes. It
12 generates brand awareness in the mail stream, so we
13 have heard, in discussions with other card issuers,
14 that this constant mailing does generate brand
15 awareness.

16 Q Does it generate any responses if you don't
17 open the envelope?

18 A I do not know that.

19 Q Is a first-class solicitation more apt to be
20 opened than one sent as standard mail?

21 A Based on my readings of the data that's
22 available, it appears first-class mail does generate a
23 higher response rate than standard mail.

24 Q No, I didn't ask that. I asked whether it
25 was more apt to be opened.

1 A Well, response rates are correlated to open
2 rates, I would believe. Now, we know that first-class
3 mail is responded to more than standard mail. We do
4 not know if that is because it reaches the recipient
5 in a greater speed time because of the forwarding or
6 because customers value first-class mail greater than
7 standard mail.

8 Q Okay. Can I summarize your answer, then, by
9 saying you don't know whether first-class
10 solicitations are more likely to be opened than
11 standard, but you know that they have a higher
12 response rate?

13 A That is correct.

14 Q Do you have any idea, since this is
15 important to this NSA, do you have any idea or insight
16 as to why solicitation mail that's sent as first-class
17 mail has a higher response rate or lift than standard
18 mail?

19 A As I just mentioned previously, I believe
20 one of the issues that we believe -- the forwarding of
21 first-class mail pieces leads to a higher lift, the
22 speed of delivery leads to a higher lift, and I've
23 heard and read that there are some consumers who look
24 at mail pieces with first-class mail and open those
25 pieces compared to standard mail pieces.

1 Q So those are the three factors you can point
2 to as to why there is a lift for mailing a piece at
3 first class: forwarding, speed of delivery, and what
4 was the third?

5 A Customer perception of first-class mail.

6 Q Customer perception. Could you take a look
7 at your response to Val-Pak 15(a)? Are you there?

8 A Yes, I am.

9 Q Okay. In your response, you state that it's
10 your understanding that potential customers who are
11 assumed to be high risk generally have higher a
12 response rate to first-class mail. Correct?

13 A That is correct.

14 Q Do you have any insight for us as to why
15 that would be true, why high-risk potential customers
16 would be more responsive to first-class mail than low-
17 risk potential customers?

18 A Generally speaking, historically, first-
19 class mail has been the preferred medium for credit
20 card issuers targeting the sub-prime market. The
21 characteristics of the sub-prime market are usually
22 customers who move more frequently than the prime and
23 super-prime markets. Based on that information,
24 first-class mail has been a perceived medium of
25 acquisition for that customer base.

1 Q So you would say, of the three factors you
2 mentioned before for what you call the sub-prime
3 market, it's less customer perception and speed of
4 delivery and mainly the forwarding aspect.

5 A I would not be able to speak for the sub-
6 prime market, what they believe to be the issues.
7 When we talk about here the use of first-class mail,
8 it is possible that the sub-prime market also values
9 first-class mail significantly to standard mail.

10 Q So, in essence, it's the same three factors.

11 A The same three factors.

12 Q So you really don't have any insight as to
13 why the sub-prime market has a higher response rate
14 other than the forwarding issue.

15 A As I just mentioned, I believe it's a
16 combination of all three factors.

17 Q Yes, but it was a combination of all three
18 factors for the low-risk market, too. There is a
19 difference, and I'm just asking you to give us insight
20 into the difference.

21 A I think the weighting of all three is very
22 different. I think maybe, while all three factors are
23 important, maybe for the sub-prime market the
24 forwarding is more important than it is for, say, the
25 prime market, and the speed of delivery is less

1 important for one market than it is for the other.
2 Maybe the weighting is different, but I believe all
3 three factors do play a role in the response rates.

4 Q When you say "maybe," I assume you're
5 speculating, to a significant degree.

6 A Yes.

7 Q Okay. "First-class mail" is a registered
8 trademark of the U.S. Postal Service, is it not?

9 A Yes, it is.

10 Q Let me refer to a response that Val-Pak
11 received to an interrogatory in the rate case. There
12 are some of us in the room that are spending a fair
13 amount of time on that, and I'm sure you necessarily
14 aren't, but I'll ask you just to assume my
15 representation is correct that Witness Pifer had a
16 response to one of our interrogatories, which was T-
17 18-9, where he defined "first-class mail" as being a
18 product of the Postal Service. I'm not asking you to
19 comment on what he said, but I'm just starting my
20 question with that predicate.

21 Would you agree that first-class mail is one
22 of the many products offered by the Postal Service?

23 A Yes, it is.

24 Q And this particular product has a registered
25 trademark, and I'm going to go into the commercial

1 world with an analogy, and this is going to be the
2 predicate of my questions. I understand that one of
3 the owners of a trademark that is of great value is
4 Louis Vuitton. Are you familiar with that company?

5 A My wife is familiar.

6 Q For the record, I believe it's spelled V-U-
7 I-T-T-O-N but pronounced "Witon." Is that your
8 understanding?

9 A Yes.

10 Q Okay. Many people understand that to be a
11 valuable trademark of a company that manufactures,
12 among other things, women's handbags and luggage and
13 watches and such. Correct?

14 A That is correct.

15 Q And it has a distinctive "LV" incorporated
16 in the design. Have you ever noticed that?

17 A Yes.

18 Q Let me ask you, have you ever heard the term
19 "junk mail"?

20 A Yes, I've heard the term "junk mail."

21 Q And as you look over the various products or
22 classes of mail offered by the Postal Service, do you
23 believe the term "junk mail" is generally applied to,
24 for example, periodicals mail?

25 A No, I do not.

1 Q Parcels?

2 A No, I do not.

3 Q Express mail?

4 A No, I do not.

5 Q Priority mail?

6 A No, I do not.

7 Q First-class mail?

8 A No, I do not.

9 Q Standard mail?

10 A No, I do not. I believe the junk mail term
11 exists in the industry, but I do not believe junk mail
12 is an appropriate term to be used to quantify and
13 explain what the value of mail is to consumers.

14 Q No. I'm not asking you your opinion. I
15 share your opinion. I'm trying to get at your
16 understanding of what people use the term to refer to.
17 Maybe I have to go back and ask the question again.

18 I asked you if you had ever heard of the
19 term "junk mail," and I asked you, of the various
20 major classes or products offered by the Postal
21 Service, do you believe that the term "junk mail" is
22 commonly applied to various classes, not whether you
23 think it's justified or reasonable or even responsible
24 to do such a thing.

25 But I'm trying to ask you what is commonly

1 done in the literature. The Postal Service responds
2 to editorials all around the country whenever the term
3 appears, and it defends itself and says there is no
4 such thing. I understand that's your position.

5 A I think my understanding of it is where I've
6 read the term "junk mail," the people who are writing
7 about junk mail do not differentiate between first-
8 class mail, standard mail, periodical -- I won't say
9 packages but periodicals, and they are referring to
10 the term "mail" as a whole. They are not segmenting
11 it as first-class mail or standard mail at that time.

12 Q That's your understanding of how the phrase
13 "junk mail" is used? It could be just as equally
14 applied to express mail or first-class mail, or
15 standard mail.

16 A I have never seen anywhere a differentiation
17 for junk mail differentiating first-class mail and
18 standard mail.

19 Q So you think it could be any of the classes
20 of mail.

21 A I think they are just referring to mail as
22 all mail.

23 Q All mail. Interesting. Do you believe that
24 the term "junk mail" has a connotation that is
25 complimentary or pejorative?

1 A Pejorative.

2 Q Okay. Now, let me ask you to look at your
3 response to our Interrogatory 23, Section A, and I
4 want to see if I understand what you said. We said,
5 "Please explain whether, in your opinion, it would be
6 reasonable to consider or think of the first-class
7 mail product as a brand of the Postal Service." And
8 your response says, "'Brand' being a somewhat vaguely
9 defined concept, first-class mail may be thought of as
10 a brand of the Postal Service and that it conveys a
11 number of possible associations or attributes."

12 Let me try to get at what you mean by
13 "brand" being vaguely defined. Do you consider the
14 Louis Vuitton brand, with the "LV" on the handbags, to
15 be a vaguely defined concept?

16 A No, I do not.

17 Q It's a readily identifiable product, is it
18 not?

19 A Correct.

20 Q And how about first-class mail? Wouldn't
21 that be a readily definable product and a brand of the
22 Postal Service?

23 A The reason that I think we defined it as
24 vaguely -- in terms of mail, the reason first-class
25 mail is a brand is maybe not the correct analogy

1 because we will be the brand for us is the U.S. Postal
2 Service, and some of our products are first-class
3 mail, standard mail, express mail, so we look at these
4 as products.

5 Now, there are instances where we do target
6 to the consumers parcel select and other shipments,
7 and those are brands, but usually, depending on who
8 the target market is, the brands are sometimes
9 expressed, and sometimes they are not emphasized.

10 Q Well, when you're talking to a mailer of
11 credit card solicitations, and you're trying to
12 convince them to use first-class rather than standard
13 mail, the brand of first-class mail has significant
14 value, does it not?

15 A That is correct.

16 Q Okay. And that's the context of this NSA.
17 Correct?

18 A That is correct.

19 Q In that context, do you think the first-
20 class mail product is a vaguely defined concept or --

21 A In terms of NSA, it is not a vaguely --

22 Q If I could finish the question. Do you
23 believe it to be a vaguely defined concept or a
24 readily identifiable product?

25 A In the terms of the NSA, from our

1 perspective, it is a brand. In terms of the
2 customers, they are looking at it as a product.

3 Q Okay. Give me the distinction, then,
4 between brand and product so I understand how you're
5 using the terms.

6 A First-class mail, from our perspective, is a
7 branded product of mail. At the end of the day, all
8 mail, I believe, is mail, but first-class mail carries
9 certain characteristics and attributes, such as
10 forwarding, return, and premium delivery. However,
11 when the customers look at it, they look at it in
12 terms of product placement. Mail is mail, and they
13 are looking at different products that the Postal
14 Service offers. One of the products we offer is
15 first-class mail and standard mail.

16 It's the same way with Louis Vuitton. There
17 might be the tote bag or the large, carry-on bag.
18 For Louis Vuitton, those might be different brands,
19 but from a consumer perspective, they are just
20 different products provided by the same manufacturer.

21 Q Let me just take one more stab at this.
22 When you started your answer, you said that the Postal
23 Service was the brand, and first-class mail was the
24 product.

25 A Correct.

1 Q And then as you went into your answer, you
2 said, first-class mail was a branded product. Can you
3 give any clarity because I'm trying to understand how
4 you use these terms?

5 A I apologize. I think I might have
6 misspoken. I'm talking in terms of the NSA. I
7 thought the question you defined later was, in terms
8 of the NSA, do you believe first-class mail is a
9 product? And the answer I thought I was answering
10 was, in terms of the NSA, first-class mail is a brand.

11 Q And there is nothing in the domestic mail
12 classification schedule or in the DMM that is vaguely
13 defined about what first-class mail is, is there?

14 A No.

15 Q Okay. Now, take a look at page 23 of your
16 testimony, lines 5 through 6, and there you say,
17 "Furthermore, the average response rate for a credit
18 card solicitation falls between 0.3 percent and 0.4
19 percent, according to our data sources." Correct?

20 A That is correct.

21 Q Would this be the general range that you
22 would expect for the solicitations being sent by WMB
23 in this NSA?

24 A I would believe so.

25 Q For bills or statements of account that are

1 sent out by companies via first-class mail, would you
2 expect that fewer than one percent of the people
3 respond; that is to say that they pay their bills?

4 A I would assume more than one percent respond
5 to their bills.

6 Q Substantially more?

7 A Substantially more.

8 Q How about for bank statements that are sent
9 first-class mail? Would you expect that fewer than
10 one percent open the statement and perhaps review it
11 and balance their checkbook?

12 A That is correct.

13 Q Fewer than one percent?

14 A I'm sorry. More than one percent.

15 Q Okay. Substantially more than one percent?

16 A Substantially more than one percent.

17 Q For brokerage statements that come out
18 first-class mail, when people open them up and look to
19 see how their investments are doing, would you expect
20 that fewer than one percent open them up and look at
21 them in that way?

22 A No, I do not. I believe that it's more than
23 one percent.

24 Q Substantially?

25 A Substantially.

1 Q Well, let's go back to your response to 23,
2 and in 23(b) we ask you a similar question having to
3 do with bank statements and statements of account.
4 Let me read that question and answer. In 23(b), we
5 say, "Would you agree that the value of a first-class
6 or FCM brand would be enhanced by the fact that FCM is
7 regarded by most mail recipients as containing items
8 that are of personal interest to them, e.g.,
9 correspondence, or that concern them personally, e.g.,
10 bank statements or statements of account?" Your
11 response is, "As I cannot confirm the premise embodied
12 in this interrogatory -- FCM is regarded by most mail
13 recipients as containing items that are of personal
14 interest to them -- I cannot agree with the
15 statement."

16 That's correct. That's your position?

17 A That is correct.

18 Q Okay. Now, let me ask you to compare bank
19 statements and unsolicited advertisements that come,
20 to which fewer than one percent of the recipients
21 respond. Is it your opinion that people are no more
22 interested in or concerned with their bank statements
23 than they are with unsolicited advertisements?

24 A No. I do not agree with that statement.
25 When we talk about the .3 to .4 percent response rate,

1 that doesn't mean that only .3 or .4 percent of the
2 customers open the mail piece. Substantially more
3 customers might open that credit card piece, and only
4 .3 or .4 percent respond to that acquisition.

5 Q Well, I'm speaking of responses -- for
6 example, I understand that more might open it, but the
7 .3 to .4 is the people who respond and fill out the
8 application and ask to get a credit card. Correct?

9 A Correct.

10 Q For example, with a bill, we're talking
11 about what percent of the people might get a bill from
12 some utility and might pay, and you agreed it's
13 substantially more than one percent. And I'm trying
14 to ask you to compare the recipients' interest in or
15 concern with bank statements compared with unsolicited
16 advertisements. Isn't it true that if you compare a
17 bank statement with an unsolicited advertisement that
18 has less than one percent of the people responding,
19 not opening but responding, is it your opinion that
20 people are no more interested in or concerned with a
21 bank statement than they are the solicitation?

22 A I have not seen any market research to
23 support that premise. I believe that consumers now,
24 as we move into more targeted credit card mailings,
25 even though it's unsolicited, the issuers are now able

1 to target offers more specifically to the individual
2 consumer, that consumers may, when they open that
3 piece, be interested in seeing what kind of pricing
4 and what kind of offers are available to them.

5 Q So your testimony before the Commission is
6 that, in your opinion, based on your multitude of
7 contacts with banks and your independent research and
8 such that you discuss in your testimony, a recipient
9 is likely to be just as interested or concerned with
10 an unsolicited solicitation as he is a bank statement
11 or a brokerage statement or a bill that needs to be
12 paid.

13 A Without seeing any market research, I cannot
14 specify exactly what consumers look at. Generally
15 speaking, from what we have heard, while the response
16 rate will not mirror that of bank statements, it's not
17 meaningless. Customers do look at what statements
18 they get, and they do look at the pricing and offers
19 within the solicitations.

20 Q I'm trying to get to your response in 23(b)
21 were you deny the premise of the interrogatory, as you
22 put it. You deny that you think that FCM is regarded
23 by most mail recipients as containing items that are
24 of personal interest, and that's your position.
25 Correct?

1 A My position is that most recipients of
2 first-class mail value it for first-class mail. Now,
3 I cannot speak to why they value first-class mail, but
4 there is a value apparently for first-class mail.

5 Q And it's not based on the personal interest
6 in seeing their bills, seeing their bank statements,
7 seeing the brokerage statements they might get; it's
8 not that. It's something else that's inherent in the
9 first-class mail.

10 A It's something inherent in first-class mail.
11 I cannot speak to that fact.

12 Q So is your answer you simply just don't
13 know, or are you saying that you believe that there is
14 no evidence that people are more interested in mail of
15 a personal interest that comes via first-class mail
16 than solicitations?

17 A I cannot speak to why the response rates are
18 higher in first-class mail. As I previously talked
19 about, there are factors that lead to a higher
20 response rate in first-class mail, but there's no data
21 that I can point to that supports exactly why first-
22 class mail might generate a higher response rate or
23 generate a high open rate or why customers value it
24 more.

25 Q Okay. Just to be clear, my question had

1 nothing to do with response rates; it had to do with
2 the last point about whether customers have greater
3 value for pieces that have personal interest to them,
4 like bank statements and brokerage statements and
5 invoices, and I take it, if you realize that's my
6 question, that your answer is the same, that you have
7 no reason to believe that people have a greater
8 personal interest in that kind of mail than they do in
9 unsolicited credit card solicitations.

10 A I think customers have a greater interest in
11 that type of mail, but they are not looking at it in
12 terms of first and standard. From my own personal
13 experience before I joined working for the Postal
14 Service, I couldn't have told you what the difference
15 between first-class mail and standard mail is, and
16 still, when I ask my wife, can you look at credit card
17 issuers, do you know which is first or standard? I
18 see very few people recognizing that fact. So just
19 from personal experience.

20 The data that we've seen, and we've talked
21 to banks, there is an inherent response rate lift in
22 first-class mail. The reason I keep coming back to
23 that is one of the reasons we've been told that first-
24 class mail has a high response rate is because
25 customers open it more. Now, we don't know what the

1 reasons are, why the customer might open first-class
2 mail more than standard mail.

3 What your question is trying to get at is
4 why are customers opening up first-class mail? What's
5 the value in it? I think what you're asking is, what
6 causes a customer to open a first-class mail piece and
7 not a standard mail piece? My answer is, we really
8 don't know why a customer opens a first-class mail
9 piece and not a standard mail piece. What you're
10 talking about, that there might be more personal
11 correspondence, might be correct, but that might be
12 just one of the factors.

13 Q But your testimony is that you don't know if
14 it's one of the factors or not.

15 A That's correct.

16 Q Could you look at your response to 23(c)
17 while we're here? We asked you, "Would you agree that
18 most mail recipients generally have lower regard for
19 unsolicited mail than they do for FCM? Please discuss
20 what the Postal Service knows in this regard."

21 Your response was, "I cannot confirm, and I
22 suspect that measuring the relative levels of regard
23 that recipients have for specific kinds of messages is
24 an imprecise science, at best." That's your response.
25 Correct?

1 A That is correct.

2 Q Does this mean that, in your work at the
3 Postal Service, that you have not seen, and you're not
4 aware of, any studies on the impact of mail?

5 A Can you clarify your question?

6 Q Sure. It has to do with 23(c). We ask you,
7 "Would you agree that most mail recipients generally
8 have lower regard for unsolicited mail than they do
9 for FCM?" And you say that relative levels of regard,
10 the study of that is an imprecise science, at best.

11 I'm asking you if you've never seen a study that deals
12 with how mailers perceive the mail that they get, the
13 impact it has on them, whether it's by different class
14 of mail or anything else, and you say it's an
15 imprecise science. That's what I'm trying to get at.

16 A That's correct. I believe there are studies
17 out there that identify the mail movement and look at
18 what is the message in the mail, but I cannot speak to
19 those at this time.

20 Q Do you think the Postal Service's marketing
21 department may have done such studies?

22 A It is possible.

23 Q Do you think the mailers and direct mail
24 firms may do such studies before they enter their mail
25 and design their mail pieces?

1 A It is possible.

2 Q But you don't know, just possible.

3 A I can't speak for all mailers.

4 Q I didn't ask you to speak for all mailers,
5 just generally.

6 A Generally, I think there is a high
7 probability that customers do that and within our
8 marketing department and finance department people
9 have looked at this issue.

10 Q In your multitude of discussions with banks
11 and credit card offerors, have you ever heard the
12 subject discussed, studies that analyze the response
13 of mailers to different types of mail?

14 A Yes, I have.

15 Q In fact, if the Postal Service is trying to
16 sell mailers on taking a piece of standard mail and
17 converting it to first-class mail, one would think you
18 might have some idea or even data explaining that the
19 mailer should expect a better response, a better
20 perception by the recipient. Isn't that correct?

21 A That is correct.

22 Q Do you have such data?

23 A No, we do not. The way the NSA works
24 currently is I think first-class mail and standard
25 mail is different for each customer, so we would not

1 be able to tell every customer that first-class mail
2 will lead to an increased response rate for each
3 individual customer. That might be true on the whole
4 for our aggregate, but for each individual customer
5 that we deal with, the economics and the marketing
6 strategies that they have, first-class mail and
7 standard mail, the strategy of choosing which class of
8 mail to use, in all probability, will be very
9 different.

10 Q So are you saying that the Postal Service
11 doesn't share information with them trying to urge
12 them to make that buy-up decision.

13 A That is correct. We look at what the
14 customer needs and how they drive. In terms of the
15 Washington Mutual Bank NSA, we've, through discussions
16 with them, understood that they have an inherent value
17 in first-class mail, and the role of the agreement was
18 to drive additional volume into first-class mail.

19 Q Well, how would a bank, WMB or any other
20 credit card offeror, decide whether or not to trade
21 up? Wouldn't they do that based on some data, some
22 study, some concrete analysis?

23 A That is correct.

24 Q And so when you respond to our question and
25 say that this is an imprecise science, at best, is

1 that a good description of what you're saying, or
2 would you like to modify that language?

3 A I think you're talking about two different
4 issues here. In the question you asked, you asked,
5 would most mail recipients have a generally lower
6 regard for first-class mail? Well, we're looking in
7 terms of what the definition of "regard" is, but from
8 a customer perspective of, say, a Washington Mutual
9 Bank, and I can't speak for exactly what their
10 marketing strategies are, they understand that they
11 have different response rates and lift rates from
12 first-class and standard mail.

13 We have not spoken to why they have those
14 different response rates and lift rates,
15 differentials, but they do see a differential. If
16 there wasn't a differential in first-class mail
17 response rates and lift rates, the agreement, as such,
18 wouldn't really drive the value for Washington Mutual
19 Bank, I believe.

20 Q Well, I guess, just to wrap it up, is it
21 fair to say that it may be an imprecise science, but
22 it's something that there are hard numbers that
23 mailers are relying on?

24 A That is correct.

25 Q Okay. If you could think back on Louis

1 Vuitton again and their brand that they protect
2 worldwide whenever they see -- have you ever seen
3 articles about them going after competitors around the
4 world or pirates who manufacture their goods?

5 A Yes, I have.

6 Q And they aggressively defend and protect
7 that trademark, do they not?

8 A That is correct.

9 Q Do you think that Louis Vuitton would
10 deliberately take actions that knowingly would cheapen
11 its brand --

12 A No, I do not.

13 Q -- or its branded products?

14 A No, I do not.

15 Q In your opinion, should the Postal Service
16 take actions that likely would cheapen its branded
17 first-class mail product?

18 A No, I do not.

19 Q Let me ask you to turn to your response to
20 our Interrogatory 4, Part E, when you get there.

21 A Yes, I am there.

22 Q I just want to clarify something. At the
23 end of the response, the last sentence, you say, "I
24 would point out that, for the most part, prices in all
25 of their subclasses are uniform with respect to

1 quantity." Correct?

2 A That is correct.

3 Q What do you mean by "for the most part," out
4 of curiosity?

5 A I'm not a rate level expert and if there are
6 any volume discounts anywhere else across the Postal
7 Service, but most of the products generally offered in
8 terms of mail do not offer quantity discounts in the
9 Postal Service.

10 Q Any illustrations you can give us in
11 standard mail of quantity discounts?

12 A There are none except for the -- NSA.

13 Q And that would be a case where quantity
14 discounts were introduced for standard mail. Correct?

15 A That's correct.

16 Q So it's, in essence, the first such set of
17 rates within standard mail.

18 A Correct.

19 Q Okay. Would you look at your response to
20 21, Val-Pak 21? All of my questions deal with Val-Pak
21 interrogatories, I believe. Part C is what I'm
22 focused on here. This is a follow-up to 4(e) where we
23 talk about prices in other subclasses being uniform
24 with respect to quantity. We say, "Do you consider
25 prices that are uniform with respect to quantity an

1 undesirable feature of most Postal Service offerings?
2 If so, please explain why you consider uniform prices
3 to be undesirable." You say, "I do not consider list
4 prices that do not vary with respect to volume to be
5 inherently undesirable."

6 There's there negatives in there, but I
7 think it's understandable. You're saying, just to
8 repeat it, "I do not consider list prices that do not
9 vary with respect to volume to be inherently
10 undesirable." Correct?

11 A That is correct.

12 Q Okay. So is that sort of, as you people
13 say, damning with faint praise? Do you have an
14 opinion about the desirability of list prices versus
15 negotiated prices?

16 A I'm not sure I fully understand what you're
17 looking for in terms of desirability. The Postal
18 Service doesn't believe discount -- it's not my
19 opinion that discount prices are not the best
20 mechanism for all of our customers. Discount prices
21 work best in an environment where we're able to
22 understand what the customer is using the mail volume
23 and better able to track and manage the system. For
24 that reason, list prices that do not vary based on
25 quantity are applicable to some of the customer

1 segments.

2 Q Let me ask you this. I'll get at that in a
3 moment. Let me follow up. You said the discounts
4 work best where you know how the mailer is using the
5 product. Don't you know how most mailers are using
6 the product?

7 A Specifically, no. In terms of a discount,
8 it only works if you're able to generate greater
9 volume or an increased contribution for the Postal
10 Service. If we were to provide discounted prices to
11 all mailers, and it did not result in an increase
12 aggregate in volume, the Postal Service would be worse
13 off, and that would not be in the best interests of
14 the Postal Service or of all our customers.

15 Q So you're talking about situations where
16 mailers have a higher-than-average elasticity of
17 demand, I take it.

18 A Not necessarily. It could also relate to
19 mail service providers who are not mailers but,
20 through discounted prices, can go and capture volume
21 that was existing at current rates and drive that into
22 their lower rates at higher volumes.

23 Q But you're including mailers that have a
24 higher-than-average elasticity of demand.

25 A That is correct.

1 Q Have you ever looked at the elasticities of
2 regular and standard ECR?

3 A Yes, I have.

4 Q And would it be fair to say that the
5 unpriced elasticity of ECR is slightly above one, and
6 for standard regular it's about .3?

7 A I cannot recall the exact numbers, but that
8 sounds correct.

9 Q In other words, the elasticity of ECR is
10 about three times the elasticity of standard regular.

11 A That is correct.

12 Q When the Postal Service, in the first
13 instance in their request, and the Commission, in the
14 second instance in their opinion and recommended
15 decision, for whatever reason, set rates which do not
16 give strong recognition to elasticity of demand, don't
17 NSAs like this with declining discounts offer the
18 Postal Service a convenient way to end run the list
19 rates?

20 A I do not believe it's an end run to working
21 with list rates. The NSAs, as a mechanism, are used
22 to generate mail volume, and that is best done through
23 the NSA process and not through niche classifications.

24 Q Well, what I'm trying to get at is, if the
25 list rates do not give strong recognition to different

1 elasticities, isn't it true that you can negotiate NSA
2 rates that do, that take advantage of above-average
3 elasticities of certain mailers?

4 A For certain mailers, that is correct.

5 Q And other than the fact that it's not good
6 to do end runs around anyone, is there any reason you
7 can say that that's not an end run around the rates
8 the Commission recommends for the product as a whole?

9 A I can't speak for how the Commission sets
10 rates, but what I do believe is the list rates offered
11 are the best rates for the entire segment of the
12 population of Postal Service customers. The NSAs are
13 a mechanism of driving additional volume for customers
14 who have elasticities, as you mentioned, different
15 than the average. Generally speaking, we are pursuing
16 NSAs with customers who have higher elasticities than
17 maybe the average customer base, and generally an
18 additional contribution would require us to lower the
19 list rates for those customers.

20 Q And you have no problems with the half of
21 customers that have higher-than-average elasticity
22 being able to be the beneficiary of NSAs, and the ones
23 that have lower-than-average elasticities not.

24 A I do not believe that's the correct way to
25 characterize this issue. In terms of the NSA

1 discount, Washington Mutual's spend will increase.
2 Contributions to the Postal Service will increase. If
3 the Postal Service could encourage other mailers to
4 increase their volumes and total contribution to the
5 Postal Service through lower rates, I believe that
6 would be a beneficial, win-win solution for both the
7 Postal Service and our customers. However, I do not
8 believe providing discounted prices to every single
9 customer will result in a total aggregate increase in
10 volume for each individual customer.

11 Q No. I don't think anyone is suggesting
12 discounted rates for everyone, or else you just change
13 the rate schedule. Correct?

14 A That's correct.

15 Q Let me ask you this. In this particular
16 NSA, there is an absolute decline in mail volume.
17 Correct?

18 A That is correct.

19 Q But the Postal Service still likes the NSA
20 because the conversion from standard to first class
21 results in an increase in contribution. Correct?

22 A That is correct.

23 Q Aside from the possibility of increased
24 contribution, putting that increased contribution to
25 the overhead expenses of the Postal Service, what

1 other advantages are there for the Postal Service of
2 offering declining block grants?

3 A Some of the more specific issues are
4 identified in the contract. If you would like, I
5 could point them out. The improved address-
6 management-practice qualities; the conversion to the
7 ACS for Washington Mutual -- all of these issues
8 within the terms of NSA were able to drive better
9 behavior into customer, identify maybe best practices
10 that can't be applied to all customers, but we can
11 apply to certain customers for them to obtain NSAs.

12 Q So motivating them to clean up their lists
13 would be one of the benefits with selected mailers.

14 A Washington Mutual and many NSA customers
15 already do a very good job of cleaning their lists.
16 What we're trying to do is increase the frequency and
17 increase the processes they use on their mail. They
18 currently all exceed the standards of the Postal
19 Service in terms of UAA mail and address hygiene.
20 What the NSA allows us to do is better manage that
21 process on an individual customer level and see how we
22 can drive greater value.

23 Q I'm going to get to that in a second about
24 comparing WMB's mail to the average. What I'm trying
25 to get at is if the Postal Service wanted to have

1 mailers take certain steps to decrease the Postal
2 Service's costs of handling it, could it not implement
3 some of those on a broader basis than just the
4 participant in the NSA?

5 A I do not know the process of how they would
6 implement this to all customers, but that is a
7 plausible explanation, to apply it to all customers.

8 Q It's possible.

9 A It is possible.

10 Q Okay.

11 A But there are, I believe, technical
12 limitations to some customers' ability to do some of
13 the issues and some of the processes Washington Mutual
14 Bank agrees to perform in the NSA.

15 Q Do you know what those specific steps are
16 that other mailers would not be able to
17 technologically handle or technically handle?

18 A I'll talk specifically to Washington Mutual
19 Bank, but from what we've seen in our implementation
20 of all NSAs, issues such as updating your address list
21 with the ACS information within two weeks, I believe
22 it is; more frequent updates of NCOA running prior to
23 mailing; many of those issues have technical
24 limitations for many of our customers. Working
25 through NSA, those are requirements that require

1 Washington Mutual to invest in some new resources to
2 use that data to update their list.

3 Q You said 14 days. Is that the one that's
4 now 90 days would reduce to 14? I'm getting confused.

5 A The ACS transaction; I think there is no
6 limitation -- currently there is nothing on that. The
7 contract requires them to take ACS transactions and
8 update those within 14 days. The current 90 days is
9 the NCOA run, which, I think, is every 90 days, and
10 Washington Mutual -- I can't exactly recall -- it's
11 either 30 days or 45 days that Washington Mutual is
12 committed to.

13 Q All right. Before we get to that point, let
14 me ask one other issue that grows out of Interrogatory
15 16, if you can turn to that, Section C. And there you
16 discuss a limitation on the use of first-class mail
17 under the NSA to the bank, and you say, "The cited
18 limitation --" I guess I have to read the question, or
19 else this isn't going to make sense.

20 The question has to do with to what extent
21 does the NSA restrict card services from cross-selling
22 products that are not card products or credit card
23 services. You say, "The cited limitation limits the
24 NSA to credit card mailings, which does include life
25 insurance and other types of financial products."

1 Correct?

2 A That is correct.

3 Q So you're saying that WMB cannot cross-sell
4 to its customers with solicitations for life insurance
5 or anything else other than a credit card.

6 A They can use the mail, and I would hope they
7 would use the mail, for their other financial
8 products, but that mail volume cannot be charged to
9 the NSA.

10 Q Exactly, not under the NSA.

11 A Not under the NSA.

12 Q Not at the discount rate.

13 A Not at the discounted level.

14 Q In fact, there are no content limitations on
15 WMB if they were to want to cross-sell to these
16 customers if they want to pay the full first-class
17 rates.

18 A That is correct.

19 Q And there are no content limitations if they
20 wanted to pay the standard mail rates.

21 A That is correct.

22 Q But the restriction comes only under the
23 NSA.

24 A That is correct.

25 Q And so tell us, what is the purpose of

1 content restrictions on the first-class mail contained
2 in the NSA?

3 A Washington Mutual, as a bank, is a very
4 diversified corporate holding. The NSA forecast forms
5 that we've included are before rates and after rates
6 volume forecasts. We are able to very accurately
7 identify exactly -- through my testimony, we are able
8 to evaluate the before rates and after rates
9 forecasts. If we were to start including a lot of the
10 other Washington Mutual mail volume over which we did
11 not have historical information or future guidance on
12 how that mail volume would go, we would be at a
13 disadvantage in setting thresholds and allowing that
14 mail volume to be part of the NSA.

15 Q Do I understand your answer to say that you
16 would have a difficult time forecasting volumes?
17 That's the main reason?

18 A Evaluating the forecasts provided by
19 Washington Mutual Bank.

20 Q I'm sorry. Could you repeat that? I didn't
21 hear it.

22 A We would have problems evaluating the
23 forecasts provided by Washington Mutual Bank.

24 Q Okay. Is that the only reason?

25 A I think that part of the reason also is

1 because we were dealing directly with the credit card
2 group within Washington Mutual Bank, which, at the
3 time, was Providian. When they did the merger, we
4 decided to only include the previous Providian, which
5 is now the credit card side of Washington Mutual Bank
6 in the NSA agreement. If we were to include, say,
7 life insurance, brokerage, or home equity loans and
8 mortgages, that would require us to evaluate different
9 volumes in the historical information, and, moving
10 forward, we did not feel that was appropriate at that
11 time.

12 Q So it all comes back to the ability of the
13 Postal Service to evaluate the customers' mail
14 volumes.

15 A That is correct.

16 Q And that's, I guess, the only reason.

17 A That is correct.

18 Q Okay. Now, on a related issue, let's look
19 at 21(b), and we asked you a question about whether
20 WMB could use the incentives to mail on behalf of
21 other customers, and there's two parts to this, but
22 you say, this provision which prohibits mailings, WMB
23 entering other people's mail, "this provision is
24 intended to ensure that the incentives embodied in the
25 declining block structure work as intended and to

1 prevent WMB, in this instance, from obtaining larger
2 thresholds by acting as a mail consolidator" and
3 thereby get deeper discounts, I assume. Correct?

4 A That is correct.

5 Q Now, again, if WMB wanted to submit as full-
6 paid, first-class mail, it could act as a
7 consolidator, if it wanted to, could it not?

8 A It could.

9 Q For example, in doing so, it might get
10 deeper presort discounts.

11 A That is possible.

12 Q If WMB, instead, wanted to use a
13 consolidator, it could do so at full rates but not
14 under the NSA. Correct?

15 A No. Washington Mutual Bank can continue to
16 use mail service providers under the NSA agreement.
17 There are certain limitations on how we identify the
18 permit volume, but there is no limitation as to how
19 Washington Mutual Bank enters the mail into the mail
20 stream.

21 Q Okay. So WMB is allowed to use mail
22 consolidators, but it's not allowed to become a mail
23 consolidator.

24 A That is correct.

25 Q Okay. What's the reason it's allowed to use

1 a mail consolidator? Could you help me with that?

2 A Well, using a mail consolidator is a primary
3 business for Washington Mutual Bank specifically.
4 That is their existing mail practice. They are not
5 experts in developing the mail and entering into the
6 Postal Service, so they use mail service providers, to
7 an extent, to do the entering of mail into the mail
8 stream from the Postal Service. If we were to take
9 away that ability of Washington Mutual to enter mail
10 into the Postal Service through MSPs, that would have
11 a negative impact on both the Postal Service and
12 Washington Mutual Bank.

13 Q Okay. I understand. I didn't know it had
14 been addressed before, and I haven't focused on it.
15 If it's in your testimony, I'm sorry. Thank you for
16 the explanation.

17 But let me just deal with these restrictions
18 that are imposed on WMB under the NSA that we've just
19 discussed, the first one being the content
20 limitations; the second being the fact that it cannot
21 act as a consolidator. In your opinion, do
22 restrictions of this sort -- are they typical of
23 competitive markets?

24 A It is my understanding, yes, they are.

25 Q And tell me how they are typical of

1 competitive markets.

2 A Let's take, for example, say, health
3 insurance for the Postal Service. We have a very good
4 health care plan. That doesn't mean that my brother
5 and my sister can take advantage of those same Postal
6 Service health care liability plans the same way, I
7 think, NSA works for Washington Mutual Bank.
8 Washington Mutual can use the NSA to get lower
9 discounts by increasing their mail volume, but we
10 cannot use it to encourage, say, the insurance side or
11 Capital One or Discover or American Express to give
12 them their mail volume to enter the Postal Service at
13 lower discounted rates.

14 Q And you draw a parallel between eligibility
15 for health insurance and --

16 A If you look at the restrictions --

17 Q -- let me finish the question -- and
18 restrictions on the NSA in this case. You're drawing
19 a parallel. You're saying that that is a marketplace
20 authority for the fact that restrictions on content
21 and on consolidation is typical in highly competitive
22 markets.

23 A That is correct.

24 Q And how do you draw the analogy to health
25 insurance?

1 A Well, what I was just saying is that the
2 Postal Service gets lower health insurance rates
3 because we are a larger organization. Those same
4 economies of scale don't apply to, say, other
5 individuals who are outside the Postal Service realm.
6 It's a competitive market. We're getting a better
7 rate for our health insurance than, say, another
8 individual.

9 The same applies in selected content
10 restriction. In terms of the NSA, we're limiting it
11 to only Washington Mutual Bank's credit card mailings,
12 and it's in the same way a restriction because we can
13 understand we're only targeting their credit card
14 mailings, we're restricting the NSA only to their
15 credit card mailings and not to allow insurance
16 mailings, mortgages, and other credit card issuers to
17 use that mail volume.

18 Q I'm going to have to think about your
19 analogy. Let me move on to the questions that go back
20 to our earlier discussion of UAA mail.

21 If you could turn to 14, your response to
22 14(a), we say, Please define or describe more
23 completely what you mean by the expression "quality of
24 a mailing list" as you use that expression, and go on
25 and ask some questions about that. Your response in A

1 indicates that it refers to the value of a prospective
2 customer and an estimate of response rates. Correct?

3 A That's correct.

4 Q Let me see if I can pose a hypothetical and
5 ask you to work through this with me. You said, "The
6 quality of mailing lists, as I describe in my
7 testimony, is meant to include the value of a
8 prospective customer and also an estimate of response
9 rates, which impacts the value calculation."

10 Suppose you had a particular mailing list,
11 and for the mailer, in making his offer to that list,
12 that every customer that he was able to attract had a
13 potential value of \$30,000 to his company, and let's
14 assume that the response rate is 2 percent, which is
15 substantially higher, I think you'll agree, than the
16 three-to-four-tenths of a percent that we discussed
17 earlier about WMB. Correct?

18 A Correct.

19 Q Okay. And the third assumption I want you
20 to make is that the UAA rate is 15 percent, which is,
21 I think you'll agree, substantially greater than the
22 4.5 percent for solicitation mail assumed in the NSA.
23 Correct?

24 A Correct.

25 Q So we've got each customer with a value of

1 \$30,000, a response rate of 2 percent, UAA rate of 15
2 percent. So we've got high value to the customer,
3 high response rate, high UAA. Correct?

4 A Correct.

5 Q Under the definition in your response to
6 that interrogatory, this would qualify as a high-
7 quality mailing, wouldn't it?

8 A It would depend on the economic factors of
9 the customer. The \$30,000 revenue might really only
10 mean \$100 in profit or \$10 in profit or zero dollars
11 in profit. It depends on what the economics of the
12 customer are and what industry they are operating
13 under.

14 Q Well, let's say it's a net value of \$30,000.

15 A If the net value of \$30,000 met the ROI of
16 the customer, it would appear to be a very good
17 mailing for them.

18 Q And in terms of the criteria you set out
19 here in your response, applying your criteria to my
20 hypothetical where we have this high value, high
21 response rate, high UAA, this would qualify as a high-
22 quality mailing. Correct?

23 A Depending on the individual factors of the
24 mailer, maybe it could be a high-value mailing.

25 Q If we're assuming that he is going to net

1 \$30,000 per person, it couldn't get much better than
2 that, could it?

3 A But if their average customer nets \$50,000,
4 then this might not be -- depending on the costs
5 associated, they would have to evaluate the ROI.
6 That's why we need to look at individual customers
7 when we look at this. Thirty thousand might look very
8 good to me and you, but to, say, another company where
9 they are generating \$50,000 net from each customer, is
10 it worth the probability of going after \$30,000 for
11 them?

12 Q Let's assume it's WMB, you know, a
13 hypothetical, and they are going to make \$30,000 per
14 year on a customer. That's probably a lot compared to
15 most customers.

16 A I would believe so.

17 Q Okay. Would that be a high-quality mailing
18 for WMB?

19 A That would be a very high-quality mailing
20 for --

21 Q Okay. When a mailing elicits that kind of
22 high response rate from high-value prospective
23 customers, the mailer could make a bundle on it.
24 Correct?

25 A That is possible.

1 Q Does the Postal Service get anything extra
2 under that circumstance?

3 A Are you suggesting that we're sharing that
4 \$30,000 net value?

5 Q Does it get any extra money in any way,
6 depending on the return and the value of the customer?

7 A The Postal Service only generates through
8 additional volume. I think one of the issues you've
9 left out is the cost of acquiring that customer in
10 your assumption. We have a \$30,000 value, 2 percent
11 response rate, and a UAA rate, but we don't have what
12 the cost is to capture that volume. Do they have to
13 mail a billion pieces? Do they have to mail a hundred
14 million pieces? From Washington Mutual's perspective,
15 I think it is that they need to understand exactly
16 what the cost of acquisition is.

17 Q Well, we did have an assumption that the
18 response rate was 2 percent, which was substantially
19 higher than the WMB assumptions of three-tenths to
20 four-tenths.

21 A But the cost of acquisition for each
22 customer, we'll say \$20,000; they would have to look
23 at that, too, in comparison. I think your analogy is
24 correct, but you would need to have cost of
25 acquisition in that example.

1 Q Well, let's assume we're just mailing
2 standard packages out of WMB.

3 A Okay.

4 Q I don't know what the cost per package is.
5 Maybe you do, but assume it's the same.

6 A Okay.

7 Q Then we are dealing with, under your
8 definition, a high-quality mailing.

9 A That is correct.

10 Q And the Postal Service is not getting any
11 extra compensation because it's such a good deal for
12 the mailer. Correct?

13 A That's correct.

14 Q Okay. But when the UAA rate is very high,
15 as it is in this hypothetical, the mailer is not
16 paying any extra postage to the Postal Service as a
17 result. Correct?

18 A Correct.

19 Q They are just paying their discounted
20 postage rate -- correct? -- if it's under the NSA.

21 A If it's under the NSA, they would be paying
22 only their discounted rate. Correct. But as the NSA
23 does, it does work to improve the UAA rate, so you
24 would see --

25 Q We'll get to that. No, I understand. When

1 the UAA rate is very high, the mailer pays no extra
2 because of that. I understand there are things that
3 you do in your NSA to try to mitigate it, but when the
4 UAA rate is high, the mailer doesn't pay more.
5 Correct?

6 A They do not pay more to the Postal Service.

7 Q So the Postal Service bears all of the
8 additional costs of that UAA mail.

9 A That is correct.

10 Q So if you have higher-than-anticipated UAA
11 rates, it causes the Postal Service profit on the NSA
12 or contribution to institutional costs, whatever you
13 want to call it, to be lower than anticipated.
14 Correct?

15 A That is correct.

16 Q And just to stay with the hypothetical for a
17 minute, solely from the standpoint of the Postal
18 Service, from the perspective of the Postal Service,
19 would you define this mailing with a 15 percent UAA
20 rate, the hypothetical I've been using, as a high-
21 quality mailing?

22 A No, I would not.

23 Q And, again, solely from the standpoint of
24 the Postal Service, do you have an opinion as to at
25 what UAA rate the Postal Service would be defined as a

1 high-quality mailing?

2 A I do not have insight into what the Postal
3 Service would qualify as a high-quality mailing.

4 Q But it would certainly be a lower-than-
5 average UAA rate. Correct?

6 A That is correct.

7 Q So if the average, I think, is 1.23 percent
8 for all first-class mail, you say, and then 1.70
9 percent for first-class automation and presort -- is
10 that correct? --

11 A That is correct.

12 Q -- that it would have to be lower than those
13 averages in order to be high-quality mailing for the
14 Postal Service. Correct?

15 A In terms of address quality -- I don't think
16 you can look at it that way in terms of average. As
17 long as the customer is doing all of the processes for
18 address hygiene that are required and are exceeding
19 those, that's a high-quality list. I believe the
20 average that we're talking about is you can't compare
21 the total average individual customer -- if Washington
22 Mutual Bank wasn't doing all of the processes that
23 they aren't going to do under the NSA and they are
24 currently doing, their UAA rate might have been, say,
25 30 percent, as an example, but because of the

1 processes that they are committed to in the NSA and
2 that they are currently doing, their UAA quality is,
3 say, 15 percent.

4 So if I look at where I'm starting from and
5 where I'm carrying it to, then I would consider that a
6 high-quality list for Washington Mutual.

7 Q Okay. Well, let's look at that as to what
8 is changing in the NSA. Your response to the Section
9 A, we just discussed, was 1.23 percent UAA for all
10 first-class mail. Correct?

11 A For all mail -- correct -- for all first-
12 class mail.

13 Q First class. Correct? Okay. And for
14 first-class automation and presort, it's 1.7 percent.
15 Correct?

16 A That is correct.

17 Q So if automation and presort have a higher
18 UAA rate than average for all first-class mail, do you
19 have any estimate of what the UAA rate is for the
20 remainder of first-class mail?

21 A I do not.

22 Q It would be perhaps around one percent.

23 A One percent. Correct.

24 Q Do you happen to know what the trend is in
25 UAA mail for all first-class mail; say, if it's 1.23

1 now, what it was five or 10 years ago?

2 A I do not have an understanding of the trend.
3 My understanding is that it has slightly increased.

4 Q But in your response to Part D of our
5 interrogatory, you confirm that the assumed rate for
6 WMB's first-class mail marketing program is 4.5
7 percent. Correct?

8 A That is correct.

9 Q Is that 4.5 percent --

10 A Have you changed questions? Are you still
11 on Question 14?

12 Q No. I'm on nine. I'm sorry. I guess I
13 didn't refer you to nine. Sorry. That's where the
14 1.23 and 1.70 --

15 A I have those down to memory.

16 Q I thought you would have those. I'm sorry.
17 I should have referenced Question 9. But in your
18 response to nine -- let me see if I can find it now -
19 - 9(d) at the top of the next page, that's where you
20 have the 4.5 percent for WMB's first-class marketing
21 mail. Right?

22 A Correct.

23 Q Okay. And I wanted to ask you what that's
24 based on. Is that based on the Postal Service's
25 experience with other NSAs, prior NSAs, or just WMB?

1 A That is a specific number as to Washington
2 Mutual Bank.

3 Q Okay. And if you take 4.5 percent of just a
4 million letters, that's 45,000 UAA letters. Correct?

5 A That's correct.

6 Q And here, UAA, as you're using it, means
7 mail that is undeliverable as addressed and not
8 forwardable either. Correct?

9 A That is correct.

10 Q So if you add the pieces that are
11 forwardable that require additional cost, that would
12 raise it beyond 4.5 percent. Correct?

13 A That is correct.

14 Q And you don't know what that number is.
15 Correct?

16 A At this time, we do not know.

17 Q Is any effort being made to find out what
18 the rate of forwarding is for NSA participants?

19 A It is one of the data requirements in all of
20 the NSAs that have gone forward so far.

21 Q But you feel that there is no useful data
22 that you've obtained in the past that would help you
23 put in a response in this case as to what you
24 anticipate.

25 A Based on our experience, it differs

1 according to the company, and to use a number, an
2 average, to Washington Mutual would not be, I think, a
3 fair estimate at this time.

4 Q Let's look at 11(d), and this will give you
5 an opportunity to expand on what you started to get
6 into before about the specific provisions in this NSA
7 to reduce UAA. In 11(d), we ask you, "What
8 consideration, if any, do you give to the goal of
9 reducing the volume of UAA mail when the mailing lists
10 used are known to contain percentages of UAA mail that
11 far exceed the average in first class?" Do you see
12 that?

13 A That is correct.

14 Q And you respond by saying, "The NSA
15 encourages the conversion of mail that results in a
16 higher overall net contribution to the Postal Service
17 we balanced against the risk of higher UAA costs,
18 however, by including provisions in the NSA to reduce
19 the amount of UAA mail." And that's what you were
20 talking about a minute ago, is it not?

21 A That is correct.

22 Q Okay. Just to clarify, are you saying that
23 the 4.5 percent estimate is after the Postal Service
24 gets the benefit of the provisions in the NSA that
25 reduce the level of UAA mail for WMB?

1 A The 4.5 percent is their historical
2 calculation of UAA mail volume.

3 Q So the 4.5 percent is not what you're
4 expecting under the NSA. You're expecting a number
5 that's lower than that.

6 A We expect it to change, to decrease.

7 Q And do you have any number for what you
8 expect it to move to?

9 A No, I do not.

10 Q If the UAA rate were 4.5 percent, it still
11 would be over two and a half times the 1.7 percent UAA
12 rate for automation and presort, wouldn't it?

13 A That is correct.

14 Q Without this NSA, WMB would likely continue
15 to enter its solicitation mail at standard mail rates,
16 would it not?

17 A There is a high probability that that is
18 true.

19 Q And when WMB enters its mail at standard
20 mail rates or standard regular rates -- it would be
21 standard regular. Correct?

22 A That is correct.

23 Q When it enters solicitations at standard
24 regular rates, some portion of that is likely to be
25 UAA as well, perhaps four and a half percent or

1 perhaps more. Correct?

2 A Correct.

3 Q So when you say that the NSA, and this is in
4 your response -- I just have to find exactly where it
5 is -- I'm sorry. I can't find my reference to the
6 quotation that I'm about to read to you, and so I
7 apologize for that. Maybe you can answer it for me
8 anyway.

9 At one point, you say that this NSA reduces
10 the amount of UAA mail for WMB. Do you recall that
11 language?

12 A I think I do.

13 Q The reference I was trying to find is in our
14 13(a)(i), and there you talked about the benefits to
15 the Postal Service, and you say that it lowers the UAA
16 rate on current first-class mail solicitations,
17 thereby increasing the amount of net contributions
18 from this mail. Do you see that?

19 A Yes, I do.

20 Q It actually is reducing the UAA rate from
21 4.5, which is, you say, historic for WMB. Correct?

22 A That is correct.

23 Q So it's reducing it from this very high
24 rate, which was two and a half times what the first-
25 class automation and presort rate is, down to some

1 level that you don't know what it's going to be.

2 Correct?

3 A That is correct.

4 Q What does the Postal Service do with
5 standard regular mail that's UAA?

6 A It is my understanding that that mail is
7 trashed.

8 Q Destroyed?

9 A Destroyed.

10 Q Is it fair to say that for standard regular
11 mail that's UAA and not forwardable that standard
12 regular mailers, in general, don't have any interest
13 in learning about which pieces were forwarded or which
14 pieces were not forwarded or UAA?

15 A I think what you're asking is, for standard
16 mail, do the customers not care about the UAA rate? I
17 would say that depends on the customers.

18 Q Not the rate. I'm sure they would care
19 about the rate because it's the percentage of their
20 mail that isn't beneficial, but they would not care so
21 much about the information coming back with a correct
22 address. Would that not be fair to say?

23 A That is fair to say.

24 Q And, in fact, if they wanted it, they could
25 ask for it and get it and pay for it. Correct?

1 A That is correct.

2 Q But what I'm trying to get at, and I've
3 never understood in any of this discussion, is if WMB
4 converts its mail from standard to first class, and it
5 didn't care what the correct address was when it was
6 in standard, why would it care to get the electronic
7 UAA information?

8 A I think they care. I think the costs at the
9 time -- the list price for standard, the costs of
10 getting that return information doesn't make it a
11 profitable mailing if they were to capture that
12 additional information. I believe they do value that
13 ACS information even in standard mail, but for that
14 mailing list, for that quality, or for the costs
15 associated at that time, it didn't make sense for them
16 to invest in that data.

17 Q Are you saying that WMB owns the mailing
18 lists that it does its solicitations to?

19 A I believe it owns some of the lists, and
20 some of them are rented.

21 Q For the ones that are rented -- do you know
22 which is the majority?

23 A I believe the majority is owned.

24 Q For the ones that are rented, do you know
25 what it would do with the information if it gets it?

1 A I believe they will provide that information
2 to their own database people and address-management
3 people.

4 Q Do you know if WMB typically uses a rented
5 list more than once?

6 A I cannot speak to how Washington Mutual Bank
7 uses their rented lists.

8 Q And if it wasn't used more than once, it
9 wouldn't have any value to them, would it, the
10 address-correction information?

11 A I do not agree with that statement. I
12 believe, from past experience, we've seen that even
13 customers when they just rent a list, they are able to
14 use ACS transactions to build databases of corrected
15 addresses, which they then use against future mailing
16 lists. There is a high probability that certain names
17 or individual addresses show up on more than one list.
18 We might be on lists A, B, and C, and when you run B
19 and C mailing lists, if you capture that information
20 from mailing list A, you would be able to correct
21 mailing lists B and C.

22 Q So it's your testimony that WMB plans to
23 take the electronic UAA information, create a
24 database, and run its subsequent mailing lists against
25 that.

1 A I can't speak to exactly how they will use
2 the ACS information, but I believe they have intents
3 to use ACS information in updating their address base.

4 Q Let me ask you to speculate with me for a
5 moment. Suppose they don't use it that way. Suppose
6 they have no more interest in getting it in first
7 class than they did in standard mail, had no plans to
8 use it. Just assume that for a moment. Have you ever
9 considered, in one of these NSAs, having an agreement
10 with a mailer that the first-class mail piece be
11 treated as though it were standard mail and allowed to
12 be trashed or destroyed?

13 A I believe the piece is being trashed and
14 destroyed when Washington Mutual Bank commits to ACS.

15 Q Fair enough, but without the benefit of
16 electronic return. In other words, get rid of it
17 completely.

18 A I can't speak to other discussions within
19 the same environment if that has been discussed or
20 not.

21 Q I'm sorry. Why can't you?

22 A I haven't been privy to any NSA discussions
23 where we have considered treating first-class mail
24 outside without the forwarding or returns.

25 Q So the answer is it hasn't been discussed,

1 to your knowledge.

2 A It may have been discussed. To my
3 knowledge, yes.

4 Q Thank you. Do you recall we had a couple of
5 questions -- it was four and 21 -- there is no need to
6 go to them perhaps -- that dealt with the ability of
7 similarly situated mailers to have access to an NSA
8 like this. At one point, you talked about the
9 availability to other mailers and then about the
10 barriers for other mailers. Correct?

11 A That's correct.

12 Q If there were lower barriers, if there were
13 no caps, and if caps really were a barrier, as you say
14 in your testimony, and if there were no transactional
15 costs, no litigation costs, and no delays, and people
16 were able to get them quicker, wouldn't it be true if
17 mailers were like WMB, you would wind up in first-
18 class mail with a lot of mail that had a 4.5 percent,
19 let's say, UAA rate instead of the lower return UAA
20 rates that are there now?

21 A Well, I think you're comparing apples and
22 oranges here. The 1.7 percent for automation presort
23 includes all types of mail. It doesn't just include
24 marketing mail. So when you compare the 1.7 to the
25 4.5 percent marketing mail, it's all probability that

1 other people who use first-class mail for marketing
2 purposes, their UAA rate is very different than the
3 1.7 percent identified. The 1.7 percent is an average
4 of customers who might have a 30 percent UAA rate and
5 customers who have a zero percent UAA rate.

6 For example, Washington Mutual has under
7 statements and correspondence mail a one percent
8 response UAA rate and a 4.5 percent UAA rate. If the
9 quantity of their marketing mail was to go down to
10 zero, they would have a UAA rate of one percent. That
11 would not be in the best interests of the Postal
12 Service because we would lose a lot of contribution-
13 positive, first-class mail volume. To understand the
14 question the way you're talking about it, we would
15 have to look and see exactly what are the UAA rates
16 for marketing mail.

17 Q You're not actually saying there are mailers
18 that have 30 percent UAA rates, are you?

19 A Your analogy on your 15 percent. There
20 might be a mailer out there who is a novice mailer,
21 and they do a one-time mailing. I can't speak to it,
22 but the 1.7 percent, as an average, means that there
23 are people disposed around that average.

24 Q Right, but if that's the average, and if
25 you're entering new first-class mail, and it has a

1 four-and-a-half- percent UAA rate, aren't you
2 necessarily increasing the average for all mailers
3 because it's averaged across all mailers?

4 A You would be if you were to encourage a
5 large proportion. Even if you were to encourage all
6 of Washington Mutual's mail volume -- I think 90
7 billion pieces is the current first-class mail base --
8 of that 90 billion pieces you're only going to be
9 adding an additional three or 400 million pieces under
10 their agreement, so it's not going to drive the
11 average significantly.

12 Q Now, that's exactly what you said in your
13 response to 21, and what I'm trying to say is, you
14 want to have NSAs readily, easily, cheaply available,
15 and I'm saying if you make this available to other
16 similarly situated companies the way that, at one
17 point, you say in the testimony -- you say that you
18 think this would be one. You made it a baseline. You
19 didn't do a follow-on to the Cap One NSA. You wanted
20 it to be a baseline. You were hoping there would be
21 others that would come to be similarly situated to it.
22 Is that not correct?

23 A That is correct.

24 Q Okay. If your dream comes to fruition, and
25 if the Commission streamlines procedures to Mr.

1 Plunkett's wildest imaginations, and you're allowed to
2 have no transaction costs virtually and just have many
3 people mail them, and they are coming in at 4.5
4 percent, I'm saying, eventually, aren't you raising
5 the costs of UAA mail within first-class mail, and
6 isn't that going to have to be built into an averaged
7 across all of the first-class mail rates?

8 A No. I do not agree with that statement. I
9 believe because even if we were encouraging that 4.5
10 percent, that cost exists in standard mail currently.
11 So say Washington Mutual was never to convert that 4.5
12 percent mail from standard into first class. Without
13 an NSA, that mail would have continued to be mailed in
14 standard rates, and you would have continually
15 incurred a cost of four and a half percent on that
16 standard mail deck, but by converting that mail to
17 first-class mail, you might get a UAA transaction the
18 first time, but the second time we would fix that
19 address, and in the aggregate, we're lowering that UAA
20 rate.

21 So the benefit is we would lower total
22 contribution costs, and the Postal Service, as a total
23 in contribution, would be much better off if we were
24 to get lots of mailers to come in, even if they had a
25 four-and-a-half-percent return rate, and get them to

1 adopt the processes Washington Mutual has committed to
2 and get them to commit to 90 percent of their
3 marketing mail volume in first-class mail, it would be
4 a positive contribution for the Postal Service.

5 Q Well, that's a nice overview from the
6 standpoint of the Postal Service, but I can assure you
7 that first-class mailers care about the rates that
8 they pay, as each class of mail does, and people tend
9 not to look at cosmic benefit to the Postal Service.

10 So my question is, is it not true that if
11 you attract many similarly situated mailers with tens
12 and hundreds of millions of pieces into first-class
13 mail, and it has four-and-a-half-percent UAA rates or
14 something similar to that, and right now the
15 percentage is much less than that, doesn't that
16 increase the costs of first-class mail, UAA, and don't
17 those costs have to be borne by first-class mail and
18 built into the rate base, so don't rates go up?

19 A I believe that the pieces they are
20 converting, there is still a contribution depositor.
21 There is still an increase in contributions to the
22 Postal Service, so the total costs will not go up, as
23 you say. I would think if there was a customer
24 involved in this, customers like Washington Mutual,
25 Capital One, Discover, Chase, Bank One, the ones who

1 are the large statement providers, combined, the five
2 NSA customers mail over maybe three and a half
3 billion, four billion statements. They are large
4 users of first-class mail. They are not interested in
5 driving the cost of postage on those statements up by
6 converting mail that's going to drive up the total
7 cost.

8 Q Well, they are not paying the total cost of
9 what they are driving up. They are paying only a bit
10 of it. They have mail that, vis-a-vis other existing
11 first-class mail, is much more expensive to handle
12 from the standpoint of the Postal Service. How can
13 you deny that that's going to have to be built into
14 the rate base and be shared by all first-class
15 mailers?

16 A We do not believe it's going to drive a
17 significant change in the UAA rate for first-class
18 mail as a whole. I take exception to the fact that
19 you say that Washington Mutual paid a lower rate.
20 They are still going to be paying the list rate on 490
21 million pieces of their first-class mail volume, which
22 is a significant portion of their existing first-class
23 mail base and their projected volume.

24 Q My question only has to do with the mail
25 that is under the NSA.

1 A I do not believe that 1.7 percent for a
2 total automation rate will change drastically by
3 encouraging greater conversion from standard to first-
4 class mail through the NSAs.

5 Q So is it your position it would increase but
6 not increase drastically?

7 A Correct. In a statistically valid way
8 either, I really doubt you would be able to drive any
9 meaningful change in the 1.7 percent.

10 Q It simply disappears in the rounding. It's
11 too small.

12 A It's too small. Correct.

13 Q The total number of pieces of credit card
14 solicitation mail, you said was what?

15 A For Washington Mutual?

16 Q No. For the whole --

17 A I said for statements, they maybe mailed out
18 4 billion statements to the NSA customers.

19 Q I thought you had speculated as to what the
20 total -- let me ask you that. Do you know that if all
21 other credit card offerors were to come in and get a
22 similarly situated, functionally equivalent NSA, how
23 much volume in first-class mail that would generate?

24 A I think the latest number I saw, I think,
25 was Dow Jones said there was anywhere from about 6

1 billion pieces of credit card solicitations in the
2 mail stream. If you were to assume that 90 percent of
3 that were mailed first class, that would be about 5.4
4 billion pieces. Currently, of that 5.4 billion, I'm
5 pretty sure we don't have 90 percent of the credit
6 card solicitation volume in first-class mail. If that
7 were to happen, you could convert -- if everyone were
8 to jump along, you would have about 4.5 billion pieces
9 of additional first-class mail.

10 Q Can you take a look at your response to
11 4(d), please? This is my last question, you will be
12 glad to know. We asked you, "Please explain fully all
13 reasons why the three conditions on page 12, lines 6
14 to 8, of your testimony could not be incorporated into
15 a set of requisite conditions for either a niche
16 classification or a new, first-class, bulk-
17 solicitation subclass." Do you see that?

18 A That's correct.

19 Q And your response was, "I have not attempted
20 to identify --" Did I read you D or E? I'm sorry.

21 A E.

22 Q E? You say, "I have not attempted to
23 identify all of the conditions that would have to
24 exist to support the creation of a niche
25 classification as herein described, nor have I

1 attempted to design prices for a subclass of this
2 kind." Is that correct?

3 A That is correct.

4 Q And then, in D, we asked you, "Why is a
5 series of NSAs, each of which is exclusive to an
6 individual mailer and which may exclude many similarly
7 situated mailers, more fair and superior to a niche
8 classification or a new, first-class, bulk-
9 solicitation subclass?"

10 Your response there was, in part, in the
11 second sentence: "I did not attempt to evaluate the
12 relative superiority of the NSA relative to
13 alternative approaches." Correct?

14 A That is correct.

15 Q And one of the alternative approaches was
16 the niche we asked you about in the question.

17 A That is correct.

18 Q Okay. You are the only Postal Service
19 witness in this case. Correct?

20 A That is correct.

21 Q And there is another witness that Mr. May
22 has from WMB, who is Mr. Rappaport. Correct?

23 A That is correct.

24 Q Do you know, in your testimony, did you
25 compare this NSA to a niche classification?

1 A No, I did not.

2 Q Did Witness Rappaport do that?

3 A No, he did not.

4 Q Why did you not do that?

5 A The NSA process, as we've identified it, I
6 think, doesn't work well within a niche
7 classification. As I've mentioned previously, part of
8 the use of discounts is to drive --

9 Q I'm sorry. Can I just interrupt just to
10 make sure you're answering the question because I
11 wasn't sure? I just asked you why you hadn't analyzed
12 niche versus NSA. Go ahead if that's your answer.

13 A It's something we've discussed previously
14 also in the NSA process. One of the limitations is
15 that discounts encourage greater mail volume. We have
16 not found it a reliable way, as of yet, to ensure that
17 the customers we're working with in the NSA process
18 are really committing to an increase in after rates
19 volume that is solely a response to the discounted
20 rates.

21 Q Let me ask you this. Are you familiar with
22 the rules of the Commission that govern consideration
23 of baseline NSAs?

24 A Yes. I'm somewhat familiar with those.

25 Q And there is an attachment to the NSA

1 request -- it's page E-11. I don't know if you have
2 that there.

3 A Yes. I'm there.

4 Q It says: "The rule states that the Postal
5 Service request for a baseline negotiated service
6 agreement shall include, one, a written justification
7 for requesting a negotiated service agreement
8 classification as opposed to a more generally
9 applicable form of classification." I'll skip two.
10 That's not what I'm asking about at the moment.

11 The response is, "These requirements are
12 discussed in the request and in the testimonies of
13 Witness Ali Ayub and Michael Rappaport."

14 Is it fair to say that it's not discussed in
15 your testimony, as you just said?

16 A You talked about an evaluation of why a
17 niche classification would be superior to that. We
18 did not evaluate why a niche classification is
19 superior to a baseline approach. What we did discuss
20 is why this works as a baseline agreement.

21 Q Okay. Why it works as a baseline agreement
22 but not as opposed to a more generally applicable form
23 of classification. Correct?

24 A That's correct.

25 Q And the same for Mr. Rappaport. Your

1 testimony, I noticed, said that you read his
2 testimony, and it's reliable, so I assume you're well
3 familiar with his testimony, and, to your knowledge,
4 he did not do this either. Correct?

5 A He did not evaluate the benefits of a
6 baseline in a niche classification, I believe.

7 MR. OLSON: Thank you, Mr. Ayub. That's all
8 I have. I appreciate it.

9 CHAIRMAN OMAS: Is there any follow-up
10 cross-examination?

11 (No response.)

12 CHAIRMAN OMAS: Are there any questions from
13 the bench? Commissioner Hammond?

14 COMMISSIONER HAMMOND: Good morning.

15 THE WITNESS: Good morning.

16 COMMISSIONER HAMMOND: I have a couple of
17 questions.

18 Are you familiar with the Commission's
19 concern that the Postal Service might give excessive
20 discounts to mail that would have been sent even if no
21 discounts were available?

22 THE WITNESS: Yes. I'm aware of that
23 concern.

24 COMMISSIONER HAMMOND: Okay. Would you
25 agree that factors other than price affect mailers'

1 decisions to send mail or not send mail?

2 THE WITNESS: That is correct.

3 COMMISSIONER HAMMOND: It is very likely
4 that over a three-year period there would be numerous
5 changes, economic changes, social changes, whatever,
6 that are likely to affect the volumes of mail sent by
7 any particular mailer.

8 THE WITNESS: That is correct.

9 COMMISSIONER HAMMOND: Okay. So how does
10 the Postal Service account for those effects whenever
11 you're negotiating NSAs?

12 THE WITNESS: I believe our evaluation of
13 the before rates forecast is our best attempt at
14 understanding what the market environment that the
15 customer is working in will operate under. I think
16 that the risk-mitigation strategies you've written
17 into the contract, such as adjustment of the
18 threshold, allow us to eliminate the fear and the
19 concern that we have about discounting any -- volume
20 in years two and three of the agreement.

21 The threshold adjustment is based off of
22 what happens in the actual year. Say we are wrong one
23 year and that there are exogenous factors that drive
24 an increase in volume. That rise in exogenous volume
25 will have an impact in total number of accounts. By

1 adjusting the thresholds in years two and three by the
2 change in the number of accounts, we've adjusted for
3 that change in economic factor, the marketing
4 perception for Washington Mutual Bank or any other
5 customers.

6 COMMISSIONER HAMMOND: So after an NSA is
7 implemented, does the Postal Service have a specific
8 procedure for determining nonprice factors have
9 affected the volume sent?

10 THE WITNESS: We look at it through the data
11 collection plans and try to evaluate what exactly was
12 driving the volume responses. We also work with our
13 customers to talk with them during the terms of the
14 NSA agreement about how are they using the discount,
15 and what are the benefits for them.

16 COMMISSIONER HAMMOND: So is that a specific
17 procedure? Is that what you have just explained to
18 me, what the specific procedure is?

19 THE WITNESS: That is correct.

20 COMMISSIONER HAMMOND: So when such occurs,
21 can you provide the Commission with a copy of this
22 procedure?

23 THE WITNESS: I believe it's included in the
24 data collection plan, some of that information, for
25 the previous NSAs, and I believe it is part of the

1 data collection requirement for this NSA also.

2 COMMISSIONER HAMMOND: So it's probably
3 contained in there, but if not, you would be willing
4 to get it to us.

5 THE WITNESS: Correct.

6 COMMISSIONER HAMMOND: Okay. All right. I
7 had one other area that I wanted to try to understand
8 a little better. I believe there is a fine or a
9 penalty or whatever you want to call it involved in
10 this NSA if Washington Mutual essentially doesn't mail
11 a certain volume under the agreement. Can you tell
12 me, from the Postal Service's viewpoint, because I
13 assume Washington Mutual will have a different
14 viewpoint, but can you tell me, from your viewpoint,
15 why the figure, \$250,000, why that is the correct
16 amount?

17 THE WITNESS: I believe both penalties are
18 \$250,000. Are you referring to the penalty for the 90
19 percent commitment of marketing mail or the \$250,000
20 penalty for 350 million pieces of first-class mail?

21 COMMISSIONER HAMMOND: I would like to hear
22 about all of it.

23 THE WITNESS: Generally speaking, I believe
24 the \$250,000 was the number that management felt was
25 penalty enough to ensure that the customers were

1 serious about the process of moving forward in the NSA
2 and that they would commit to certain volume levels
3 that would result in contribution for the Postal
4 Service. I cannot speak to exactly why \$250,000 was
5 chosen or, say, \$500,000, but the \$250,000, I believe,
6 Postal Service management believed was a significant
7 deterrent to the customers to ensure that they were
8 interested in pursuing the NSA agreement.

9 COMMISSIONER HAMMOND: Well, okay. So you
10 yourself don't know whether \$250,000 is the
11 appropriate amount.

12 THE WITNESS: I believe it is an appropriate
13 penalty amount to our customers if they do not fail to
14 meet the requirements in the NSA. I think part of the
15 process is the penalty of \$250,000 isn't something
16 that the Postal Service just chooses. It's part of
17 the negotiation process. So when the customers we
18 work with identify -- say, we talk about a penalty of
19 a million dollars, even if they don't believe that
20 that penalty will be enforced, they have to manage
21 that million-dollar penalty. During the course of
22 negotiations, the Postal Service identifies what do we
23 have to give up to increase that \$250,000 penalty.

24 I think both the Postal Service and the
25 customers do not believe that the penalty will be

1 applied, but we want a significant penalty that
2 illustrates to the Commission and to the other
3 observers that the penalty is a real penalty; it's not
4 there for show.

5 COMMISSIONER HAMMOND: Well, maybe I just
6 don't understand. Why do you say that the penalty
7 might not be applied? What do you mean by that?

8 THE WITNESS: I think it's in neither the
9 Postal Service's or the customers' interests that the
10 penalty be applied. I think we both want to drive
11 mail volumes to increase. The penalty is there to
12 ensure that if the business environment changes or
13 something changes at the customer level, and they are
14 not able to pursue the NSA the way it was meant to be
15 implemented, there is a transaction penalty cost for
16 them. That transaction penalty cost is identified as
17 \$250,000.

18 COMMISSIONER HAMMOND: Okay. So basically,
19 you have just answered why. Okay. All right. Great.
20 I think that's all I have for right now. Thank you.

21 THE WITNESS: Thank you.

22 CHAIRMAN OMAS: Commissioner Tisdale?

23 COMMISSIONER GOLDWAY: Could I just ask one
24 brief follow-up on Tony's last question?

25 Does that penalty relate at all to what the

1 potential costs would be to the Postal Service if the
2 guarantees aren't met, or is it just a number out of
3 the hat?

4 THE WITNESS: I think it is supposed to
5 cover the transaction costs of pursuing the NSAs.

6 COMMISSIONER GOLDWAY: But not the losses
7 the Postal Service might experience if the volumes
8 aren't met.

9 THE WITNESS: If the volumes are not met,
10 the Postal Service doesn't really have any loss
11 because we would not have paid any discounts out in
12 terms of incentives. For these penalties to be
13 applied, Washington Mutual would have earned zero
14 dollars in incentives, so the Postal Service's loss
15 would be zero in terms of providing any incentives.

16 COMMISSIONER GOLDWAY: Okay.

17 CHAIRMAN OMAS: Commissioner Tisdale?

18 VICE CHAIRMAN TISDALE: I just have a couple
19 of questions, one concerning your answer to OCA
20 Interrogatory 25.

21 THE WITNESS: Yes, sir.

22 VICE CHAIRMAN TISDALE: In your response,
23 you provide a formula there that includes cross-
24 elasticities.

25 THE WITNESS: That is correct.

1 VICE CHAIRMAN TISDALE: But you say that you
2 can't use the formula because Washington Mutual's
3 volume estimates can be used only to obtain cross-
4 elasticity of a known price elasticity but not both.

5 THE WITNESS: That is correct.

6 VICE CHAIRMAN TISDALE: You also say in that
7 answer that the main factor that affects volume in
8 this NSA is the cross-elasticity. Is that correct?

9 THE WITNESS: That is correct.

10 VICE CHAIRMAN TISDALE: And the Postal
11 Service accepts Washington Mutual's claim that all of
12 the standard mail will convert to first class in
13 response to discounts.

14 THE WITNESS: Yes, up to 90 percent, we
15 believe.

16 VICE CHAIRMAN TISDALE: Up to 90 percent?
17 Okay. Isn't that basically what a cross-elasticity
18 is, a measure of how much mail would change from one
19 class to another?

20 THE WITNESS: That is correct.

21 VICE CHAIRMAN TISDALE: Okay. That's all I
22 have.

23 CHAIRMAN OMAS: Is there anyone else who
24 wishes to cross-examine the witness?

25 (No response.)

1 CHAIRMAN OMAS: There being none, Mr.
2 Alverno, would you like some time with your witness?

3 MR. ALVERNO: Yes. Thank you, Mr. Chairman.
4 Maybe, like, four minutes or so?

5 CHAIRMAN OMAS: Fine. Thank you.

6 (Whereupon, a short recess was taken.)

7 CHAIRMAN OMAS: Mr. Alverno, before you
8 redirect, I would like to ask the witness a couple of
9 questions, if I may.

10 Mr. Ayub, in your discussion with Mr. Olson,
11 you said that you thought that perhaps the Postal
12 Service's marketing department had done some research
13 about the relative value that customers place on
14 first-class and standard mail. Do you think it would
15 be a good idea to review this research before
16 negotiating an NSA?

17 THE WITNESS: I believe the data that we're
18 looking for in terms of the mail moment is what Mr.
19 Olson was getting to, and I don't want to speak for
20 him, but the Postal Service is looking at what can we
21 do drive total response rates. I don't think we
22 believe that the introduction of the credit card
23 solicitations will degrade that first-class mail
24 moment.

25 CHAIRMAN OMAS: You also indicated earlier

1 that you do not go into negotiations with a sense of
2 relative value that a potential NSA partner places on
3 first-class or standard mail. You also seem to agree
4 that mailers probably do study this issue. Doesn't it
5 place the Postal Service at a disadvantage in the
6 negotiation if the mailers understand how it values
7 classes of mail, and the Postal Service doesn't?

8 THE WITNESS: I apologize if that's the way
9 the response came out. The Postal Service does
10 evaluate how customers use first-class mail and
11 standard mail. What we do is look at how they used it
12 in the past and what the trends have been in first
13 class and standard. So when we see what the cost
14 impact is to them and how their marketing budgets
15 changed, we look to see how their allocation moves
16 between first and standard. What we don't do is
17 evaluate exactly what's the value they place on a
18 customer that they captured through first-class mail
19 versus one they gained through standard mail.

20 CHAIRMAN OMAS: Thank you.

21 Mr. Alverno?

22 MR. OLSON: Mr. Chairman, before you go to
23 redirect, could I follow up on something you asked?

24 CHAIRMAN OMAS: Yes.

25 MR. OLSON: Mr. Ayub, in response to

1 Chairman Omas's question, did you use the phrase
2 "first-class mail moment"?

3 THE WITNESS: That is correct.

4 MR. OLSON: Could you define that for us?

5 THE WITNESS: It is my understanding that
6 there is a study within the Postal Service that
7 describes the mail moment, then identifies exactly
8 what the characteristics are of consumers who, when
9 they open the mail stream, what are their reactions,
10 and what type of mail they capture.

11 MR. OLSON: So, in other words, when someone
12 opens a piece of first-class mail, there is something
13 special about it to them. Is that what this study
14 would show? Is that what you're saying?

15 THE WITNESS: That is correct. That is my
16 understanding of the study.

17 MR. OLSON: Is that study public? Do you
18 know? Is there a library reference or anything like
19 that?

20 THE WITNESS: I do not know.

21 MR. OLSON: Thank you, Mr. Chairman.

22 CHAIRMAN OMAS: Thank you, Mr. Olson.

23 Mr. Alverno?

24 MR. ALVERNO: Thank you, Mr. Chairman. We
25 only have two brief questions on redirect for Witness

1 Ayub.

2 REDIRECT EXAMINATION

3 BY MR. ALVERNO:

4 Q Mr. Ayub, when you were having a discussion
5 with Mr. Olson concerning standard mail and it being
6 discarded if it was UAA, that is, undeliverable as
7 addressed, when, in fact, is that true? When is UAA
8 standard mail discarded?

9 A To clarify my position, UAA standard mail is
10 only destroyed if it does not bear any additional
11 endorsements that require either forwarding, return to
12 sender, or any other auxiliary services.

13 Q Thank you, Mr. Ayub. Also, in your exchange
14 with Commissioner Hammond, you mentioned -- I believe
15 you used the words "if the NSA is enforced." Could
16 you clarify your statement, please, when you're
17 referring to the term "enforcement of the NSA"?

18 A I apologize. The Postal Service will
19 enforce all aspects of the contract with the NSA. The
20 penalty, though, will be enforced if we have to apply
21 it. When I talked about enforcing the penalty, what I
22 meant is there might be circumstances that exist under
23 which the penalty might not be applied, not enforced.

24 Q And by applying the penalty, you're
25 referring to the set of circumstances that would give

1 rise to the penalty in the first place. Is that
2 correct?

3 A That is correct.

4 MR. ALVERNO: Thank you, Mr. Chairman.
5 That's all I have.

6 CHAIRMAN OMAS: Thank you, Mr. Alverno.

7 Mr. Ayub, that completes your testimony here
8 today. We do appreciate your appearance and your
9 contribution to our record, and you are now dismissed.
10 Thank you.

11 THE WITNESS: Thank you.

12 (Witness excused.)

13 CHAIRMAN OMAS: Mr. May, before we begin
14 with your witness, I thought maybe we would take a 15-
15 to-20-minute break, and we'll come back and begin with
16 Mr. Rappaport. Thank you.

17 (Whereupon, a short recess was taken.)

18 CHAIRMAN OMAS: Mr. May?

19 MR. MAY: I call Michael Rapaport to the
20 stand.

21 Whereupon,

22 MICHAEL RAPAPORT,

23 having been duly sworn, was called as a
24 witness and was examined and testified as follows:

25 //

1 DIRECT EXAMINATION

2 BY MR. MAY:

3 Q Would you, please, identify yourself and
4 your position with Washington Mutual Bank?5 A Yes. My name is Michael Rapaport and I am
6 the executive vice president for marketing services
7 for Washington Mutual Card Services.8 Q I've previously showed you two copies of a
9 document captioned "revised direct testimony of
10 Michael Rapaport, on behalf of Washington Mutual Bank,
11 WMB-T-1." Did you have a chance to examine those two
12 copies?

13 A Yes, I did.

14 Q And I have given those two copies to the
15 reporter. Do you adopt those as your testimony today?

16 A Yes.

17 Q And if you were to testify fully, this would
18 be your testimony?

19 A Yes.

20 Q Are there any changes to this testimony?

21 A No, sir.

22 MR. MAY: Thank you. Mr. Chairman, I move
23 the admission of the testimony of Michael Rapaport
24 into the record. And instead these be appended in the
25 record, we decided to print non-Postal witnesses for

1 clarity.

2 CHAIRMAN OMAS: Is there any objection?

3 (No objection.)

4 CHAIRMAN OMAS: Hearing none, I will direct
5 counsel to provide the reporter with two copies of the
6 corrected direct testimony of Michael Rapaport. That
7 testimony is received into evidence. However, as
8 proponent testimony, it will be transcribed.

9 (The document referred to was
10 marked for identification as
11 Exhibit No. WMB-T-1 and was
12 received in evidence.)

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Postal Rate Commission
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**BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001**

WMB-T-1

**RATE AND SERVICE CHANGES TO
IMPLEMENT BASELINE NEGOTIATED
SERVICE AGREEMENT WITH
WASHINGTON MUTUAL BANK**

Docket No. MC2006-3

**REVISED DIRECT TESTIMONY
OF
MICHAEL RAPAPORT
ON BEHALF OF
WASHINGTON MUTUAL BANK**

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June 8, 2006

Revised 06-08-2006

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**DIRECT TESTIMONY OF
MICHAEL RAPAPORT
ON BEHALF OF
WASHINGTON MUTUAL BANK**

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8 **AUTOBIOGRAPHICAL SKETCH**

9 My name is Michael Rapaport. I manage the Marketing Services Group for
10 Washington Mutual Bank's Credit Card business ("Card Services"). My group's
11 responsibility includes direct marketing campaign execution and marketing analysis. I
12 have been in my current role for 3 years. Prior to that, I spent 14 years at Fair, Isaac and
13 Company in a variety of roles including developing some of the earliest FICO scoring
14 models and ultimately managing the FICO Score line of business for North America.
15 (The FICO Score is used by most lenders to determine a consumer's creditworthiness
16 prior to granting additional credit). I graduated from Stanford University with a degree in
17 Mathematical and Computational Sciences.

18 **I. PURPOSE AND SCOPE**

19 The Postal Service and Washington Mutual Bank ("WMB") have entered into a
20 baseline Negotiated Service Agreement ("NSA") with respect to WMB's Card Services,
21 which is now the subject of this proceeding. My testimony will provide a brief history of
22 WMB Card Services, explain Card Services' approach to marketing, its use of Standard
23 Mail and First-Class Mail and demonstrate why the NSA will encourage Card Services to
24 shift its usage from Standard Mail to First-Class Mail. My testimony will also provide
25 information on Card Services' address hygiene practices and return mail volumes.

26

Revised 06-08-2006**1 II. HISTORY OF WMB CARD SERVICES**

2 WMB Card Services was created on October 1, 2005 when Washington Mutual,
3 Inc. successfully completed its acquisition of Provident Financial Corporation
4 ("Provident"). At the time of its acquisition, Provident was the eighth largest card issuer
5 with 9.7 million customers and \$20 billion in managed credit card receivables. After its
6 acquisition, Washington Mutual established the Card Services group as its fourth
7 business line in addition to Retail Banking and Financial Services, Home Loans and
8 Commercial Banking. The proposed NSA applies only to WMB's Card Services
9 business.

10 III. WMB CARD SERVICES' MAIL TYPES

11 While WMB's other three business lines use multiple marketing channels
12 including television, radio and print advertisements, WMB Card Services relies virtually
13 exclusively on direct mail and telemarketing to promote its business. Like other card
14 issuers, WMB Card Services mail types can be generally divided into two (2) kinds of
15 mail: operational mail and marketing mail. Operational mail usually includes periodic
16 statements, communications with customers regarding their card account and mailings of
17 new or replacement cards. Marketing mail generally includes marketing materials
18 designed to attract new customers or encourage existing customers to utilize their credit
19 card and related products and services. While operational mail is sent using First-Class
20 Mail, marketing mail may be sent via either Standard Mail or First-Class Mail.

21 IV. FIRST CLASS MAIL AND STANDARD MAIL VOLUME HISTORY

22 As shown in Table 1 below, WMB Card Services' total mail volumes grew
23 consistently from 2003 to 2005. WMB Card Services' total mail volume

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1 grew from 410 million pieces in 2003 to 543 million pieces in 2004 and 647 million
2 pieces in 2005.¹ The increase in total volume from 2003 to 2005 was largely a result of
3 the success of Providian's restructuring efforts which commenced in 2001. As recently
4 as the first calendar quarter of 2003, Providian experienced a 17% charge-off rate which
5 directly impacted mail volumes by: 1) reducing the total number of active accounts; 2)
6 reducing the total marketing budget; 3) requiring significant portfolio sales, which also
7 reduced the number of active accounts; and 4) yielding regulatory limitations on the types
8 of customers to whom Providian could solicit. Also, as part of the restructuring,
9 Providian developed a new marketing strategy, testing of which began in the second half
10 of 2002, and was fully rolled out throughout 2003. By 2004, Providian's "turnaround"
11 was largely successful and the company's new marketing strategy was fully implemented
12 with an increased budget allowing total mail volume to increase from 410 million in 2003
13 to approximately 543 million in 2004.

14 In 2005, total mail volume increased to 647 million due to several factors.
15 Increased growth in the card portfolio prompted an increase in the marketing budget for
16 2005, thereby enabling more marketing mail. Additionally, as the credit quality of the
17 portfolio improved, there were more existing customers to whom marketing materials
18 could be sent. Specifically, marketing mail to our existing customers rose from 35
19 million pieces in 2004 to 70 million pieces in 2005 (exclusively First-Class). Also,
20 notably, Washington Mutual's acquisition of Providian was completed in October, 2005
21 and as a result a one-time merger notification to existing customers was mailed using
22 First-Class Mail. Further, and in connection with the merger, management made

¹ Note that these historical volumes and those in Table 1 do not include a small amount of Standard Mail fulfillment volumes (an average of about 3-5 million pieces per year) because they would be unaffected by the NSA.

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1 additional marketing budget available to cross-sell the new WMB credit card to existing
2 WMB customers. Table 1 summarizes the Historical Mail Volumes.

3
4 **Table 1: Historical Mail Volumes (in millions)**

5

Mail Class/Type	CY 2003	CY 2004	CY 2005
First-Class Mail	393	362	524
Operational	118	119	121
Marketing	275	243	403 ²
Standard Mail Solicitations	17	181	123
Total Mail Volume	410	543	647

6

7 **V. FIRST CLASS MAIL AND STANDARD MAIL VOLUME FORECASTS**

8 To understand how WMB Card Services arrived at its volume forecasts for the 3
9 years of the proposed NSA, some background into the Marketing Strategic Planning
10 Process may be useful. Next, I will discuss the methodology we employed to determine
11 our forecasts, and more specifically, to demonstrate the cost-effectiveness of the
12 proposed NSA.

13 WMB Card Services' process begins by establishing yearly account goals
14 consistent with the business' strategic growth targets. With account goals established, we
15 determine a marketing budget by estimating the costs to acquire an account. Factors
16 which affect these 'account acquisition costs' include competitive pressure, an economic

²This figure is approximately 124 million pieces higher than the estimate included in my testimony as originally filed. There are two major reasons for this discrepancy. First, the 2005 volumes that were originally reported inadvertently excluded all solicitations (70 million pieces) sent to existing cardholders. Second, the original 2005 volumes did not reflect the additional volumes – including a one-time merger notification sent to the bank's credit cardholders (11 million pieces) and cross-sell solicitations sent to Washington Mutual customers (20 million pieces) – that resulted from the merger with Washington Mutual Bank. The 403 million piece First-Class Mail marketing volume figure included in this revised version of my testimony includes all of these volumes.

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1 downturn or higher solicitation costs, all of which increase the acquisition costs, and
2 improved response models, new market expansion or lower solicitation costs, which may
3 reduce the acquisition costs.

4 During the year, WMB Card Services monitors its performance with respect to its
5 account goals. Should account acquisition costs change, Card Services re-optimizes its
6 mail strategy within the same budgetary constraint. Thus, if the account acquisition costs
7 increase such that the established marketing budget is no longer adequate to obtain the
8 account goal, Card Services will reallocate its spending among marketing campaigns
9 most likely to achieve meaningful results. If account acquisition costs decrease such that
10 unused marketing budget is available, Card Services will consider investing the
11 additional spend in development efforts such as testing.

12 Based on our analysis of past response and booking rates as well as the
13 competitive environment, to meet our account goals for Year 1 (2006) acquisition efforts,
14 Card Services estimates that we will mail a total of 564 million acquisition mail pieces
15 (which do not include solicitations sent to existing cardholders) (or approximately 118
16 million more acquisition mail pieces than we sent in 2005) using a combination of
17 Standard Mail and First-Class Mail. While this mail volume forecast is derived from
18 2006 account goals, not prior year volume, we note that the 118 million piece change in
19 total acquisition volumes from 2005 to 2006 is larger than the 57 million piece change in
20 the previous year. It is the account goals for Year 1 (2006), and not the prior year's
21 volume which drives the 564 million total acquisition mail volume estimate.

22 Next, to forecast the mail class mix, we used the mail class mix from the last two
23 (2) quarters of 2005 (58% First-Class, 42% Standard) and applied it to this estimated total

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1 acquisition mail volume to determine mail class volumes for 2006 (327.1 million First-
2 Class, 236.9 Standard), as shown in Table 2.³

3 Next, Card Services assumed a 5.4 percent postal increase for all mail classes,
4 beginning in January, 2006. To cover the increased postal costs, we would either have to
5 reduce our total mail volume or shift volume to Standard Mail from First-Class Mail and
6 our strategy is to perform the latter. Therefore, in order to keep mail volumes constant
7 without additional marketing budget, Card Services shifted more than 20% of the First-
8 Class volume to Standard, thereby reducing the First-Class volume to 250 million mail
9 pieces, as shown in Table 2. Additionally, in 2006, the use of First-Class Mail for
10 acquisition mail is expected to be heavier in the first half of the year, and as marketing
11 budget is expended, Standard Mail volumes are expected to increase.

12

13 **Table 2: Year 1 Acquisition Mail Volumes**

Acquisition Mail Volumes	Total	Standard	First
Baseline Acq Mail	564,000,000	236,880,000	327,120,000
Mix Adj.- Postal Increase	564,000,000	314,000,000	250,000,000

14 *The figures in this table do not include solicitation mail pieces sent to existing customers.
15 These 80 million pieces are included in Table 3 below.
16

17 Our operational mail volumes and the volume of marketing mail that we send to
18 our cardholders are also a result of our account goals. Given our account goals, we
19 expect 2006 operational and customer solicitation volumes to be similar to 2005 volumes.

³ We excluded cross-sell marketing mail pieces to Washington Mutual customers when calculating this mail class split percentage. This is because, when we began these mailings immediately after the Washington Mutual acquisition in 2005, we mailed all of the cross-sell pieces using First-Class Mail while, in 2006, we expect to mail these pieces using a similar mail class split as all other marketing pieces.

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1 To determine Before Rates volumes for Years 2 and 3 of the proposed NSA, Card
 2 Services assumed that volumes would grow by approximately five (5) percent annually.⁴
 3 This assumption was driven by 2 factors: 1) internal projections forecasting account
 4 growth of five (5) percent per year for each of Year 2 and Year 3; and 2) expectation of
 5 higher acquisition costs per account due to increased marketplace competition and "list
 6 fatigue" which occurs when the same prospects are mailed repeatedly without any
 7 development efforts, resulting in lower response rates over time. Table 3 shows the Card
 8 Services' three (3) volume forecasts without the rate discount provided by the NSA.

Table 3: Mail Volume Forecasts (Before Rates)

Mail Class/Type	Year 1 ⁵	Year 2	Year 3
First-Class Mail	450	475	500
Operational	120	125	130
Marketing	330	350	370
Standard Mail Solicitations	314	330	345
Total Mail Volume	764	805	845

11
 12 **VI. AFTER RATES VOLUME AND THE IMPACT OF THE NSA**
 13 Card Services expects that the NSA will cause it to mail virtually all, if not all, of
 14 its solicitations as First-Class Mail. As discussed in Section V, at current rates, it is cost
 15 effective to mail a significant portion of our acquisition mail as Standard Mail. This is
 16 because, for much of our acquisition mail, the lift (i.e., the higher response rate) from

⁴Note that, after increasing the volumes by five percent annually, Years 2 and 3 volumes were rounded to the nearest five or ten million pieces as deemed appropriate.

⁵ Note that the reduction in total First-Class Mail volume from 524 million pieces in 2005 to 450 million pieces in 2006 is driven by the change in the mail class split for acquisition mail discussed above, not by reductions in total mail volume. In fact, Card Services plans to mail nearly 117 million more mail pieces in 2006 than in 2005.

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1 using First-Class Mail rather than Standard Mail does not justify the average ten-cent
2 higher First-Class Mail postage.

3 We performed a breakeven analysis using our targeting engine. The targeting
4 engine found that reducing the postage difference between First-Class Mail and Standard
5 Mail to six cents (a four-cent reduction) would justify switching all of our acquisition
6 mail to First-Class Mail. Our targeting engine found that at a four-cent discount (the
7 “breakeven discount”), the response rate lift from using First-Class Mail (nearly 20
8 percent) offsets the higher First-Class Mail postage cost. At the breakeven discount and
9 assuming a constant budget, Card Services would mail less acquisition mail pieces
10 (approximately 84 pieces of First-Class Mail would replace every 100 pieces of Standard
11 Mail), but the lift from using First-Class Mail would allow us to acquire the same number
12 of customers.

13 The response rate lift from using First-Class Mail is the result of two different
14 sources. First, as mentioned above, consumers simply respond more to First-Class Mail
15 than to Standard Mail. Second, sending a smaller volume of First-Class Mail (than if the
16 acquisitions were sent as Standard Mail) allows us to mail only to the better prospects on
17 our list.

18 Applying this analysis to the NSA, the discounts (which average slightly more
19 than four cents per incremental piece of First-Class Mail) will cause WMB to replace 314
20 million Before Rates Standard Mail pieces with 263 million First-Class Mail pieces in
21 Year 1. As shown in Table 4, similar shifts would occur in Years 2 and 3.

22 The NSA would also produce a secondary effect on Card Services acquisition
23 mail volumes. Card Services plans to reinvest the discount above four cents in additional

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1 acquisition First-Class Mail. Table 4 summarizes Card Services' After Rates forecasts.
2 Exhibit A attached hereto provides additional details.⁶

3 **Table 4: Mail Volume Forecasts (After Rates)**

Mail Class/Type	Year 1	Year 2	Year 3
First-Class Mail	713	750	785
Operational	120	125	130
Marketing	593	625	655
Standard Mail Solicitations	0	0	0
Total Mail Volume	713	750	785

4

5 **VII. CAPPING DISCOUNTS AT COST SAVINGS IS NOT ECONOMICALLY**
6 **VIABLE**

7 As discussed above, I fully expect that the NSA discounts will induce Card
8 Services to mail all of its solicitations as First-Class Mail. This will increase our First-
9 Class Mail volumes by 250 to 300 million pieces per year and thereby significantly
10 increase the contribution of our mail to Postal Service institutional costs.

11 We are aware that the Commission has conditioned approval of previous NSAs on
12 the imposition of a cap on the total amount of the discounts. However, those NSAs were
13 functionally equivalent to the Capital One NSA. Our NSA is not. This is a baseline
14 agreement that depends on its own internal values and economics, and not on the fact that
15 it is like some previously approved NSA.

16 In this case, capping discounts at cost savings will significantly reduce, if not
17 entirely eliminate, the increased contribution. To induce the desired change in behavior,

⁶ I did not update the analysis shown in Exhibit A and the resulting After Rates forecasts based upon the renegotiated declining block rate schedule because the new schedule will not have a significant impact on our After Rates volumes. While the renegotiated schedule reduces the economic benefit of the NSA to Card Services (e.g., by \$100,000 in Year 1) that can be reinvested into additional First-Class Mail, it still provides enough total discount to make it cost effective for us to migrate all of our marketing mail to First-Class Mail.

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1 the Postal Service will need to offer Card Services postal discounts in excess of \$10
 2 million per year. I understand from the Postal Service that a cost savings cap would be
 3 about \$10 million over the entire three-year duration of the NSA. Thus, the NSA
 4 discounts would be exhausted one year into the deal. Once the cap on discounts is
 5 reached, WMB Card Services would revert to its lower-contribution "Before Rates"
 6 mailing patterns. This is because once the cap is reached and WMB is ineligible for
 7 additional NSA discounts, First-Class Mail postage will again be about ten cents higher
 8 than Standard Mail postage. As discussed in Section VI, for much of our acquisition
 9 mail, the lift from using First-Class Mail does not justify the ten-cent higher postage cost.

10 Further, since the NSA as negotiated just exceeds breakeven for WMB Card
 11 Services, I believe that implementing the agreement's requirements would not be
 12 economically justifiable if Card Services only received postage discounts for a year.
 13 Given this, if the Commission imposes a cap of approximately \$10 million on postage
 14 discounts, the economic rationale for WMB Card Services' participation in the NSA
 15 would be lost. This would be unfortunate because I believe the NSA as executed benefits
 16 both parties.

17 **VIII. ADDRESS HYGIENE AND RETURN MAIL VOLUMES**

18 As required under the NSA, Washington Mutual will continue its practice of only
 19 using addresses that have been processed against National Change of Address / Coding
 20 Accuracy Support System databases within the 90 days prior to mailing. Based upon this
 21 practice, our recent return rates were approximately 1 percent for operational mail and
 22 4.5 percent for marketing mail.⁷ Also, as part of the agreement, WMB Card Services has

⁷ These return rates were calculated using 2005 data for acquisition mail and 2003-2004 data for mail (including operational and marketing pieces) sent to existing customers.

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1 agreed to update its databases for soliciting non-cardholders using ACS data. While
2 using ACS data could reduce our return rate, thereby reducing Postal Service costs and
3 increasing the value of the agreement to the Postal Service, I conservatively estimate that
4 our return rates for the duration of the NSA will be similar to our recent return rates.
5 While these requirements have value to the Service, the principal value of the NSA to
6 USPS is the significant increase in First-Class Mail volumes and net contribution to
7 institutional costs.

8 **CONCLUSION**

9 The proposed NSA creates strong economic incentives to Card Services to
10 redirect Standard Mail volume to First-Class Mail. We are not asking the Commission to
11 approve this NSA because of the incidental cost savings that are part of the deal; rather,
12 this NSA is a baseline agreement; it is not functionally equivalent to previous
13 agreements; and it should be judged on its own merits. We believe that the volume
14 projections before- and after-rates are quite realistic and, because of that, should mitigate
15 concerns about potential losses to the Postal Service. In the deals struck in previous
16 NSAs, where caps were imposed in order to limit potential losses to the Postal Service,
17 the cap still permitted the agreements to have economic viability for the partners. That is
18 not the case here. This deal will not work for Card Services if the amount of the
19 discounts is capped so that no discounts are available in Years 2 and 3. As we testify,
20 that would kill this deal for Card Services. There would be no economic incentive to
21 convert Standard Mail to First-Class and, therefore, there would be a reversion to the
22 *status quo ante*, and a very large conversion of First-Class Mail to Standard Mail in Years

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- 1 2 and 3. That makes no sense for Card Services and it certainly would make no sense for
- 2 the Postal Service. We urge the Commission to approve the deal that we made.

Exhibit A. Calculation of After-Rates First-Class Mail Volume (in Millions)

Year	Before Rates Volume			Migration From Standard to First-Class Mail			Reinvestment of Benefit		After-Rates
	Total	First-Class	Standard	Incr. FCM Vol	Total Discount	Discount/Pc	Benefit	Incr. FCM Vol	FCM Volume
	[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
Year 1	764	450	314	263	\$10.7	\$0.041	\$0.2	0.4	713
Year 2	805	475	330	274	\$11.4	\$0.041	\$0.4	1.1	750
Year 3	845	500	345	283	\$11.9	\$0.042	\$0.6	1.5	785

[1],[2],[3] WMB-T-1, Table 3

[3] All of these pieces are acquisition mailpieces.

[4] Approximate number of acquisition First-Class Mail pieces required to obtain the same number of responses as the Standard Mail pieces in [3]. Further, with 4-cent discount, these First-Class Mail acquisition pieces can be mailed at about the same total cost as the Standard Mail pieces in [3].

[5] NSA discount for mailing combined First-Class Mail volume in [2] and [4]. (Calculated assuming 5% per year increase in the volume threshold.)

[6]=[5]/[4]

[7]=[4]*([6]-\$0.04)

[8] Approximate First-Class Mail volume that can be sent with "benefit" in [7].

[9]=[2]+[4]+[8]

Note: To protect confidentiality, numbers in this exhibit are approximations.

1 CHAIRMAN OMAS: Mr. Rapaport, have you had
2 an opportunity to examine the packet of designated
3 written cross-examination that was made available to
4 you this morning?

5 THE WITNESS: Yes, sir.

6 CHAIRMAN OMAS: If the questions contained
7 in that package were posed to you orally today, would
8 your answers be the same as those previously provided
9 in writing?

10 THE WITNESS: Yes.

11 CHAIRMAN OMAS: Are there any corrections or
12 additions you would like to make to those --

13 THE WITNESS: No.

14 CHAIRMAN OMAS: -- answers? Counsel, would
15 you, please, provide two copies of the testimony --

16 MR. MAY: That's this --

17 CHAIRMAN OMAS: Okay. Is there any written
18 cross-examination for witness -- excuse me -- is there
19 any additional cross-examination for Witness Rapaport?

20 (No Response.)

21 (The document to was marked
22 for identification as Exhibit
23 No. OCA WMB-T-1-11 and was
24 received in evidence.)

25 //

BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, DC 20268-0001

Rate and Service Changes to Implement
Baseline Negotiated Service Agreement
with Washington Mutual Bank

Docket No. MC2006-3

DESIGNATION OF WRITTEN CROSS-EXAMINATION
OF WASHINGTON MUTUAL BANK
WITNESS MICHAEL RAPAPORT
(WMB-T-1)

Party

Interrogatories

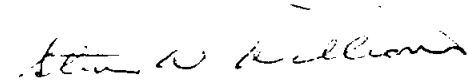
Office of the Consumer Advocate

OCA/WMB-T1-1-11

Postal Rate Commission

POIR No. 1, Question 1-4
POIR No. 2, Question 1

Respectfully submitted,



Steven W. Williams
Secretary

INTERROGATORY RESPONSES OF
WASHINGTON MUTUAL BANK
WITNESS MICHAEL RAPAPORT (T-1)
DESIGNATED AS WRITTEN CROSS-EXAMINATION

<u>Interrogatory</u>	<u>Designating Parties</u>
OCA/WMB-T1-1	OCA
OCA/WMB-T1-2	OCA
OCA/WMB-T1-3	OCA
OCA/WMB-T1-4	OCA
OCA/WMB-T1-5	OCA
OCA/WMB-T1-6	OCA
OCA/WMB-T1-7	OCA
OCA/WMB-T1-8	OCA
OCA/WMB-T1-9	OCA
OCA/WMB-T1-10	OCA
OCA/WMB-T1-11	OCA
POIR No 1. Question 1-4	PRC
POIR No 2. Question 1	PRC

OCA/WMB-T1-1. Please refer to your testimony at page 4, lines 9-13. You identify competitive pressure and an economic downturn as factors that increase WMB's acquisition costs.

- a. Do changes in interest rates or in the state of the economy affect the solicitation mail volume of WMB? If so, please explain how.
- b. Do changes in *expected future* interest rates or in the *expected future* state of the economy affect the solicitation mail volume of WMB? If so, please explain how.
- c. For each year of the proposed NSA, please state your beliefs as to the direction of change of interest rates and the direction of change of the state of the economy.
- d. Did your beliefs (as to changes in interest rates or in the state of the economy over the term of the NSA) change during the course of negotiations with the Postal Service? If so, how did your changing beliefs affect volume estimates, the **final level of discounts**, or thresholds adopted?
- e. If interest rates or the state of the economy actually differ from current **expectations** during the term of the NSA, will after-rates volumes differ from forecasts? Please explain your response.

RESPONSE

(a)-(b) Section V of my testimony discusses the factors Card Services considers in developing its marketing budget, which are the basis of the marketing mail volume forecasts in my testimony. While the state of the economy can influence these factors, **these market conditions** are not primary determinants of our marketing mail volumes. Our business growth targets are the largest determinants of budget and mail volume.

(c)-(d) I haven't developed strong beliefs regarding how these factors will change over the next few years. Section V of my testimony discusses the basis of my before-rates volume forecasts.

(e) Section VI of my testimony explains how Card Services developed its after-rates volume forecast. The impact of the NSA on acquisition mail volume is driven by the "lift" from using First-Class Mail, not by interest rates and the state of the economy. My belief is that "lift" is not impacted by interest rates or the state of the economy.

OCA/WMB-T1-2. Please refer to lines 5-6 of page 7 of your testimony. You refer to “the response rate lift from using First-Class Mail (nearly 20 percent)” Has WMB ever tested relative response rates of First-Class and Standard Mail using identical (other than indicia) pieces? If so, please describe any such tests in as much detail as possible. If not, what is the basis for the “nearly 20 percent” lift?

RESPONSE

Yes, we have tested relative response rates of First-Class and Standard Class Mail.

WMCS used observed response rate lifts from tests of First Class and Standard Class mail. Our testing varied the indicia and controlled for other response rate factors. Mail pieces were identical except for the indicia. The test lists were selected at the same mail depth and prospects were randomized for unbiased samples. In the tests, First Class and Standard Class mail pieces were dropped on the same day. Retests were also conducted for revalidation purposes. Retest results were consistent with prior results and validated response rate lifts from mailing First Class. In 2003, we tested in four different campaigns in July, August, September, and October. In 2004, we tested in three different campaigns in June, July and August.

OCA/WMB-T1-3. Please refer to lines 13-15 of page 7 of your testimony. When planning a mailing campaign, does WMB sort prospects (or lists of prospects) by

- a. expected present value to WMB,
- b. expected response rate,
- c. some other basis?

Please describe in as much detail as possible how WMB determines how many pieces of mail to send as part of a single mailing campaign.

RESPONSE

When planning a mailing campaign, we generally use a proprietary targeting engine that maximizes return on investment subject to budget constraints. Our targeting engine takes the factors identified in (a) and (b) of this interrogatory into account when determining the number of pieces to send, the class of mail to use, and to which prospects pieces should be sent. Other factors that the engine takes into account include expected credit loss rates of a given campaign.

OCA/WMB-T1-4. At page 4, lines 9-21, you discuss the effects of changes in “account acquisition costs.”

- a. Please explain how “competitive pressure” increases acquisition costs.
- b. Please explain how “an economic downturn” increases acquisition costs.
- c. Please describe in as much detail as possible all components of “solicitation costs.”
- d. Please explain how “improved response models” reduce acquisition costs.
- e. Please explain how “new market expansion” reduces acquisition costs.

RESPONSE

(a) Competitive pressures generally reduce response rates, thus increasing the cost to acquire a new account.

(b) During economic downturns, credit constraints on campaigns may be tightened. This reduces the number of marketable prospects, which increases the cost to acquire.

(c) The primary components of solicitation costs are postage and production costs. I understand that witness Ayub (USPS-T-1) calculates WMB’s average postage by class of mail in Appendix A of his testimony. While I am not comfortable providing an exact estimate of the production costs for WMB mailpieces, I understand that witness Buc (BOC-T-2) provided production cost estimates in Attachment 2 to his testimony in Docket No. MC2004-3. The items described in his testimony are similar to the items we would include in our mail campaigns and the costs are also very similar (although postal rates and production costs have increased since witness Buc’s testimony was written).

(d) Improving our models allows us to target our mailings to better prospects, increasing response rates and reducing the cost to acquire an account.

(e) Response rates in expanded credit card markets are generally higher than in established markets. The higher response rate reduces the cost to acquire an account.

OCA/WMB-T1-5. Please refer to page 4, lines 22-24, of your testimony.

- a. Please describe in as much detail as possible the process that led from “our account goals for Year 1” to “a total of 564 million acquisition mail pieces.”
- b. Please define the term “booking rates” on line 22.

RESPONSE

(a) We first determine how many new accounts we need to acquire to meet our growth targets. Then, we determine how many solicitations we need to send to acquire those accounts. In general terms, the number of acquisition mailpieces is equal to the number of new accounts divided by the product of the expected response rate and the expected booking rate.

(b) Booking rate is the number of accounts generated divided by the number of responses received.

OCA/WMB-T1-6. Please describe in as much detail as possible the process by which WMB determines whether to use First Class or Standard Mail in a mail marketing campaign.

RESPONSE

Response rate assumptions and postage costs for First Class and Standard Class mail are inputted into our proprietary targeting engine. The mail class decision is made using the targeting engine discussed in OCA/WMB-T1-3. In general terms, First-Class Mail will be chosen if the lift justifies the additional cost.

OCA/WMB-T1-7. Please define the term “development efforts” on line 21 of page 4 of your testimony. Please define the term “development efforts” on line 7 of page 6 of your testimony.

RESPONSE

In general, development efforts refer to activities which have the potential to generate additional value beyond current practices. Examples of development efforts include, but are not limited to, new credit card products, revised pricing or new creative packages.

OCA/WMB-T1-8. Please explain why Operational volume declined from 123 million in 2005 (Table 1, page 3) to 120 million in Year 1 (Table 3, page 6).

RESPONSE

As noted on the bottom of page 5, I expect 2006 operational mail volumes to be similar to 2005 volumes. Similar to the process discussed in footnote 2 on page 6 for Years 2 and 3, the difference is due to rounding.

OCA/WMB-T1-9. Please refer to lines 16-20 of page 3 of your testimony. Please provide 2005 volumes that have been reconciled with Postal Service records.

RESPONSE

We are currently reviewing our 2005 volumes and reconciling them with Postal Service records and will report our findings as soon as they are completed.

OCA/WMB-T1-10. Please refer to lines 15-16 of page 4 of your testimony. Has WMB ever “reoptimize[d] its mail strategy” for 2006? If so, please describe that process in as much detail as possible.

RESPONSE

To this point, mail strategy for 2006 has not been reoptimized, as campaigns are tracking to account goals and acquisition costs are in line with expectations.

OCA/WMB-T1-11. This interrogatory seeks information on the reaction of Washington Mutual Bank (WMB) to rate changes. Please refer to your revised testimony at page 6, lines 6-9, which seems to say that WMB reacts to rate changes by changing the proportions of First and Standard marketing volumes, subject to the constraints that the total number of marketing pieces remains the same and the marketing budget remains the same.

- a. Is this a correct restatement of your testimony? If not, please identify the errors in the restatement.
- b. Please describe how WMB will react to the R2006-1 rate changes when they take effect.

RESPONSE

- (a) No. Your restatement describes WMB's reaction to the most recent rate increase. The error in your restatement is that it suggests that WMB will employ this exact same approach to every rate change. In reality, we will analyze each particular rate change and determine the best strategy for meeting our growth goals subject to our budget constraint.
- (b) Assuming that the NSA is in place, then it will likely make sense for WMB to continue to send the vast majority of our marketing mail as First-Class Mail. Thus, our most likely reaction to the R2006-1 rate increase would be to modestly reduce our total marketing mail volume.

**RESPONSE OF WMB WITNESS RAPAPORT TO PRESIDING OFFICER'S
INFORMATION REQUEST NO. 1.**

1. Question 1 seeks to gain an understanding of the relation between solicitation mail and operational mail based upon estimates provided by witness Rapaport, and calculations made as shown in Table 1.

Table 1							
2005-Year 3 Before Rates Estimates					Percent Changes		
Mail Class	2005	Year 1	Year 2	Year 3	2005 to Year 1	Year 1 to Year 2	Year 2 to Year 3
	1	2	3	4	5	6	7
	Millions	Millions	Millions	Millions			
First Class	524	450	475	500	-14.12% ^a	5.56% ^a	5.26% ^a
Operational	121	120	125	130	-0.83% ^a	4.17% ^a	4.00% ^a
Marketing	403	330	350	370	-18.11% ^a	6.06% ^a	5.71% ^a
Standard Mail Solicitation	123	314	330	345	155.28% ^a	5.10% ^a	4.55% ^a
Standard Mail Solicitation	647	764	805	845	18.08% ^a	5.37% ^a	4.97% ^a
Total Solicitation Mail Volume Estimated on Form 12	526	644	680	715	22.43% ^a	5.59% ^a	5.15% ^a
Estimated on Form 12 operational mailings per year	1008	1000	1042	1083	-0.83% ^a	4.17% ^a	4.00% ^a

- a. Please confirm that the absolute volumes taken from Tables 1 and 3 of WMB-T-1 revised are reproduced in Table 1, columns 1-4, above and that the percentage calculations in columns 5-7 made based on those volumes are correct.

- b. Page 7 of WMB-T-1 Revised states that Before Rates volumes will grow by approximately 5 percent annually in year 2 and Year 3 of the Negotiated Service Agreement (“NSA”)
 - i. Were these estimates based on estimates of booking and response rates for Year 2 and Year 3 of the NSA?
 - ii. Please explain why the growth rate in before-rates total solicitation mail volume appears to decline from 22.43 percent (2005 to Year 1) to approximately 5 percent in the following two years.
- c. Please refer to Table 1 above. Please explain why a 22.43 percent growth in total solicitation mail volume between 2005 and Year 1 would result in essentially no growth in customers, while a 5.59 percent growth in total solicitation mail volume between Year 1 and Year 2, would result in a 4.17 percent growth in customers.

RESPONSE

- a. Confirmed with one caveat – The assumption that each customer receives 12 operational mailings is not accurate since not every customer receives a statement every month and operational mail includes miscellaneous mail (e.g., replacement plastics) in addition to monthly statements.
- b. i. As described on page 7 of my testimony, these estimates were primarily based on internal projections forecasting account growth of five (5) percent per year. A secondary factor considered was expected increases in marketplace competition and list fatigue, which generally reduce response rates, thus increasing the cost to acquire a new account.
- ii. In the 4th quarter of 2005 (after WMB acquired Provident Financial), we began mailing credit card offers to existing Washington Mutual customers. Also, in the 4th quarter of 2005, we began mailing more offers to existing credit card customers. So, 2005 only contains one quarter of this additional mail volume whereas the Year 1,

Year 2 and Year 3 forecasts include full year volumes for credit card cross-sell programs to WMB customers and the change in marketing strategy to existing credit card customers. This results in a more significant volume gain in Year 1 with smaller increases in Years 2 and 3.

- c. As my answer to 1a explains, the absolute number of accounts in Table 1(a) is not entirely accurate. However, there is a trend to higher account growth with lower solicitation growth and is explained as follows.

The large increase in solicitation volume from 2005 to Year 1 is mostly a result of increases in Standard Class mail volume, which yields lower response rates and, therefore, lower numbers of new accounts. In addition, we estimate that the relative lack of growth in accounts from 2005 to Year 1 is a reflection of increased competition in our market space which means lower response rates and higher attrition rates for our existing customers.

From Year 1 to Years 2 and 3, our expectation is that our credit card sales in Washington Mutual retail stores (aka branches) will become a greater percentage of our account growth – these accounts are booked without a solicitation mailing accompanying it.

**RESPONSE OF WMB WITNESS RAPAPORT TO PRESIDING OFFICER'S
INFORMATION REQUEST NO. 1.**

2. This question seeks to understand the own-price elasticity estimates of First Class Mail that can be derived from data provided in WMB-T-1. Please confirm that using the change in First Class marketing mail volumes in WMB-T-1 Revised, Table 2, which is explained to be what would have been the response to an across-the-board rate increase of 5.4 percent in all mail classes, coupled with operational volume data of 120 million pieces provided for Year 1 in Table 3 in your Revised Testimony, would produce an own-price elasticity of First Class Mail equal to approximately -3.2 as shown in Table 2 below.

Table 2					
Mail Class	Year 1 Before 5.4% Rate Increase	Year 1 After 5.4% Rate Increase	% Change in First-Class Volume	% Change in Price	Own-Price Elasticity of First-Class mail
	1	2	3	4	5
			(2-1)/1		(4/3)
First Class	117	370	-17.2%	5.4%	-3.2
Operational	120	120			
Marketing	327	250			

RESPONSE:

I can confirm your calculations with the caveat that the volume figures in Table 2 accompanying this question exclude 80 million First Class Mail marketing mail pieces sent to existing cardholders (see the note on Table 2 of my testimony). Also, since I am not an economist, I cannot address whether your approach to calculating the own-price elasticity of WMB's First-Class Mail is correct.

**RESPONSE OF WMB WITNESS RAPAPORT TO PRESIDING OFFICER'S
INFORMATION REQUEST NO. 1.**

3. For this question, please refer to Table 3 below:

Table 3								
Mail Class	2005	Year 1 After Rates	Price Per Piece Before Rates (\$)	Increase in First- Class Volume (Millions)	% Change First- Class Volumes (Millions)	Average Discount Per Piece of First- Class Mail	% Change in Price Per Piece of First- Class Mail	Own Price Elasticity of First- Class Mail
	1	2	3	4	5	6	7	8
				(2a -1a)	48/1 a		6a/3d	58/7a
First Class	171	713		242	51.33%	0.015	-4.35%	-11.80
Operational	121	120	0.326					
Flat-rate	300	593	0.346					
Incremental Volume			0.341					

1a = product 2b/2c, 3b/3c = 2b/2c.

1a million First Class pieces at an incremental discount of \$.035 + 40 million First-Class pieces at an incremental discount of \$.04 + 153 million First-Class pieces at an incremental discount of \$.045 + 153 million pieces at an incremental discount of \$.05.

- a. Please confirm that using data provided in USPS T-1_Appendix_ARevisedv3.xls, Sheet "Contrib Inputs", cells D7 and D8 for cells 3b and 3c in Table 3; and data from worksheet "Volume calc." cells F15, G15, F7, F8, G13, and G14 for cells 1a, 2a, 1b, 1c, 2b, and 2c in Table 3, along with Revised Rate Schedule 630A, used to calculate the Average Discount per Piece of First Class mail in cell 6a of Table 3, yields an own price elasticity for First Class mail estimate of -11.80 as shown in Table 3 above.

- b. Please account for the difference in estimates of the own-price elasticity of First-Class Mail shown in Question 2, Table 2, of negative 3.2, and Question 3, Table 3, of negative 11.80.

RESPONSE

(a) Confirmed assuming that the \$0.015 figure in column 6 is calculated by dividing the Year 1 NSA discount by the entire After Rates volume.

Also, my testimony estimates that the average discount per incremental piece of First-Class Mail is \$0.041 (see Exhibit A of my testimony). Substituting \$.041 for \$.015 in Table 3, Column 6 generates a “% Change in Price Per Piece of First-Class Mail” figure in Column 7 of approximately 12% and an “Own Price Elasticity of First-Class Mail” figure in Column 8 of 4.3.

(b) I am not an economist and am uncomfortable commenting on the exact meaning of the different elasticities calculated in Tables 2 and 3.

Nonetheless, I would note that the NSA discounts (which are analyzed in Table 3) substantially reduce the price difference between First Class Mail and Standard Mail while the “across the board” rate increase (which is analyzed in Table 2) does not. As discussed in Section VI of my testimony, the price difference between First Class Mail and Standard Mail has a large influence on our mail class decision for marketing mail. The reduction of the price difference between First Class Mail and Standard Mail may be contributing to the larger elasticity calculated in Table 3.

Also, Table 3 compares 2005 volumes with Year 1 volumes. Some of the change in First-Class Mail volume shown in Table 3 relates to the growth in total solicitation volume between 2005 and Year 1. For the Rate, see POIR No. 1, Table 1.

**RESPONSE OF WMB WITNESS RAPAPORT TO PRESIDING OFFICER'S
INFORMATION REQUEST NO. 1.**

4. WMB-T-1 Revised, page 10, states that "...since the NSA as negotiated just exceeds breakeven for WMB Card Services, I believe that implementing the agreement's requirements would not be economically justifiable if Card Services only received postage discounts for a year." Please explain the meaning of "breaking even" in this context. For example, isn't it the case that your breakeven analysis shows that the NSA is economically beneficial to WMB during the first year of the agreement?

RESPONSE

1. "Breakeven" as used in the quoted statement from my testimony refers to the breakeven analysis described on lines 3 to 12 of page 8 of my testimony. As shown in Exhibit A of my testimony, the *breakeven analysis found that the NSA discounts will provide an economic benefit to WMB in the first year of the agreement.*

If the NSA discounts are only available for one year, WMB will have to address the question of whether the benefit of the NSA for one year justifies (a) the effort required to implement the NSA; and (b) the address hygiene, solicitation mail volume, and other commitments WMB made as part of the agreement. I am not sure that the Year 1 economic benefit is sufficient to justify implementing the NSA. In addition, there would be the disruption attendant upon converting much of our premium mail from first class back to standard mail.

**RESPONSE OF WASHINGTON MUTUAL BANK WITNESS RAPAPORT TO
PRESIDING OFFICER'S INFORMATION REQUEST NO. 2**

QUESTIONS

- a. Have the co-proponents considered the impact of the recently issued Bank One and Bookspan Opinions on the Washington Mutual Bank Negotiated Service Agreement Request?
- b. What concerns and issues expressed by the Commission in the Bank One and Bookspan Opinions, including but not limited to the application of the Alternative Model for Negotiating Volume Discounts, have the co-proponents considered?
- c. Of the issues considered in 1(b) above, what were the results of any analysis performed, and what were the conclusions drawn from the analysis?
- d. What modifications have the co-proponents proposed to be made to the Washington Mutual Bank Negotiated Service Agreement Request after consideration of the analysis performed and conclusions drawn as referenced in 1(c) above?

RESPONSE

- a. WMB's focus while the proceeding was temporarily suspended was on reviewing our volume request and ensuring that the agreement (as renegotiated) would still benefit the company. However, we did also consider the impact of the recently issued Opinions on our NSA.

The major item that WMB considered – albeit more in qualitative terms than quantitative – was the Commission's application of the Panzar framework to the Bookspan NSA.

I understand that, in the previous NSAs, the Commission capped discounts at cost savings because it did not find the volume estimates reliable. While, in the Bookspan NSA, the Commission again did not find the volume estimates reliable, the Panzar framework allowed the Commission to include volume effects in its evaluation of the NSA.

I found this to be encouraging. If, like in its analysis of the Bookspan NSA, the Commission evaluated the WMB NSA based upon its impact on WMB volume (however measured) as well as its cost savings (rather than based upon its cost savings alone), the Commission would be more likely to approve the NSA. At a minimum, such an evaluation would likely result in the imposition of a protective mechanism that is much less limiting than a cost-savings cap.

- d. WMB did not propose any modifications based upon the qualitative analysis described in response to 1(b) or c.

1 CHAIRMAN OMAS: This then brings us to oral
2 cross-examination. No participants filed a request
3 for oral cross-examination of this witness. Is there
4 any participant, who wants to cross-examine Witness
5 Rapaport?

6 (No Response.)

7 CHAIRMAN OMAS: There are questions, Mr.
8 Rapaport, that will be asked to you from the bench
9 later on. I will -- the Commissioners have a number
10 of questions that they will ask you later. We ask
11 questions and the presiding officer's information
12 requests concerning how two recent decisions might
13 impact Washington Mutual Bank NSA. You responded that
14 you thought about those decisions, but didn't change
15 your current proposal in response to those decisions.
16 Is that correct?

17 THE WITNESS: That's correct.

18 CHAIRMAN OMAS: Let me briefly explain my
19 concern. In one of those decisions, the Commission
20 felt obligated to impose a cap on discounts. That was
21 the Bank One NSA. I know you have testified you
22 didn't want your NSA limited to a cap. The focus of
23 my questions is going to be to explore whether the
24 proposed Washington Mutual Bank is sufficiently
25 different from the Bank One NSA to justify proceedings

1 without a cap. First, how far in advance do you plan
2 your marketing? Do you plan for the period such as
3 three months, or a year, or does that vary?

4 THE WITNESS: It varies; but, typically, we
5 plan for a year at a time and we, also, have a five-
6 year plan that the Bank has in general around our
7 growth targets and our balance targets.

8 CHAIRMAN OMAS: How do you determine the mix
9 of first-class instead in mail you're using any one
10 marketing cycle?

11 THE WITNESS: Essentially, the way it works
12 is that if you think about our statement mailing and
13 our typical customer solicitation mailing to our
14 existing customers, that's all first-class mail for
15 various reasons. Obviously, for statements, I think,
16 most would agree that statements need to go first
17 class. There are regulations around it, as well. And
18 then for customer mailings, largely, since they are to
19 our existing customers, sometimes having checks in
20 them, et cetera, those go first class.

21 Then, our solicitation mailing for new
22 customers, there's a set of those potential customers
23 for which the returns that we see, if one of those
24 customers were to respond and book an account with us,
25 are sufficient enough to warrant the use of first-

1 class mail to solicit those people. And, typically,
2 those are targeting engine, which is a sort of an
3 optimization routine, mathematical optimization
4 routine, will tell us that a first-class stamp on
5 those solicitations will get us the returns that we
6 need.

7 And then there's a set beyond that, where
8 there is sort of an incremental benefit and a response
9 benefit, if we mail those folks, but it doesn't equate
10 to sending a first-class stamp, in which case we would
11 send a standard class mail to those prospects.

12 CHAIRMAN OMAS: Does the effectiveness of
13 one marketing campaign impact a type of campaign you
14 will use in the future?

15 THE WITNESS: Absolutely, yes.

16 CHAIRMAN OMAS: Here is the nub of my
17 problem. The Postal Service is in a public monopoly
18 and the Commission can't authorize giving excess
19 discounts for mail that would have been sent anyway
20 without a discount. You have asked for a three-year
21 NSA, even though you feel it meant that your volume
22 estimates for that far in advance into the future are
23 very speculative. So, the Commission can't really
24 know whether it is being asked to give discounts for
25 mail that would be set even without a discount. Why

1 are you requesting a three-year NSA? Did the Postal
2 Service push for a three-year deal or did Washington
3 Mutual Bank? Or was it really not an issue?

4 THE WITNESS: I would say that it really
5 wasn't an issue; but I think from our perspective, for
6 us to go through the work involved to meet the
7 requirements of an NSA, frankly, a longer-term
8 arrangement benefits us, because there is some
9 substantial operational work that we need to go
10 through to take advantage of some of the -- or to meet
11 the requirements of the NSA that are on Washington
12 Mutual's behalf.

13 CHAIRMAN OMAS: I don't know whether you're
14 aware of this, but last week, the Postal Service filed
15 a request to extend the Capital One NSA. The Postal
16 Services asked for a recommended decision from us, in
17 time for them to review and implement it before the
18 current agreement expires on September 1. So, really,
19 they're asking for a decision in about a month.
20 Without prejudging anything, let's assume for a moment
21 that the Commission is able to accommodate this
22 request for expedition. Would the ability to renew or
23 extend an agreement in such a short time frame make an
24 NSA of a shorter duration easier to justify?

25 THE WITNESS: I would say yes and no. No,

1 from the standpoint of if we, Washington Mutual Bank,
2 makes the commitment to change the way that we do our
3 mailings to meet the requirements that we have within
4 the NSA around return mail and how we handle it, it's
5 important for us to know that this deal will go and
6 extend beyond just a one-year term. But, at the same
7 time, if I knew that it would be expeditious and that
8 we could get extensions, sure, that would be helpful;
9 however, it still doesn't take away from the notion
10 that for a one-year term, there's a lot of work
11 involved to get this -- our requirements done.

12 CHAIRMAN OMAS: Mr. Rapaport, in your
13 revised testimony at page eight, you mention a
14 targeting engine --

15 THE WITNESS: Yes.

16 CHAIRMAN OMAS: -- that you use to estimate
17 the first class is more attractive, this standard, if
18 you get a four cents discount. Would you, please,
19 describe for us in more detail?

20 THE WITNESS: So, as I mentioned, there's a
21 certain set of our solicitation volume where when we
22 load in to the targeting engine the expected cost of
23 that particular mailing and the expected response
24 rates, the expected booking rates of those particular
25 responders, and the profitability that we would see

1 from those particular customers, the targeting engine
2 will evaluate and say a first-class stamp will still
3 pay back your returns in the time frames that we need
4 them to pay back. Then, there are others where, for
5 various reasons, the response rates are lower, the
6 bookings rates may be lower, the profitability for
7 those customers may be lower, such that a first-class
8 stamp is not justified. So, we'll say, mailing
9 standard class stamp. However, in doing various tests
10 of mailing standard class and first class to those
11 types of customers, we have been able to determine
12 that the difference of four cents would make it
13 valuable for us to move those standard class pieces to
14 first class for those segments of the population.

15 CHAIRMAN OMAS: We are very aware of the
16 need to protect sensitive information. At this point,
17 all we want is a general description. But, if you
18 could provide details, that would be very helpful.

19 THE WITNESS: Details beyond what I just
20 talked through?

21 CHAIRMAN OMAS: Yes.

22 THE WITNESS: Okay. In particular, if you
23 think -- I mean, again, this is not, I think, rocket
24 science, but, basically, the returns that we see on
25 customers, who are slightly more risky from a credit

1 perspective, the returns are higher there. So, as a
2 result of that, in those particular sets of the
3 population, we might mail more first-class mail,
4 because we know that we can get the returns there. In
5 addition to that, in those segments of the population,
6 the time between the time we send that mailing and the
7 time these people respond, their credit profiles can
8 change. And as a result of that, the shorter window,
9 which first-class mail provides, between the time that
10 it's sent and the time we see the returns, allows us
11 to book more of those customers, because their credit
12 profiles have maintained themselves over that period
13 of time. Whereas, if there's a longer period of time
14 and their credit profiles may have degraded some, by
15 nature of our credit risk assessments, as well as
16 certain regulations that we're under by the
17 regulators, who regulate our business, we are not
18 allowed to book those particular customers. So, in
19 those areas, first-class mail tends to be the area
20 that we have found works, and that's part of our
21 threshold that we talk about in our testimony and in
22 the deal.

23 COMMISSIONER GOLDWAY: Could I interrupt to
24 just clarify that?

25 CHAIRMAN OMAS: Yes.

1 COMMISSIONER GOLDWAY: So, when I heard this
2 at first, I assumed, obviously incorrectly, that you
3 make more money off the high end affluent people you
4 might mail to. But, you're saying, you make more
5 money off those people with the credit risk, because
6 they need new credit cards. Is that correct?

7 THE WITNESS: Our profitability tends to be
8 a little bit better there, because we do get their
9 response and we do get good customers. And in
10 addition to that, we have learned over time to find
11 the customers, where we can manage the risk associated
12 with those. And --

13 COMMISSIONER GOLDWAY: Okay. So would that
14 profile, as well, of people, who have a little more
15 risk, that you're making money off of, be people, who
16 move more often, so you might have more change of
17 address with them?

18 THE WITNESS: New movers tend to be a larger
19 proportion of our target market and what we call our
20 middle market, than they do in the more prime market.
21 That's correct.

22 COMMISSIONER GOLDWAY: So, a first-class
23 piece that includes forwarding --

24 THE WITNESS: That's correct.

25 COMMISSIONER GOLDWAY: -- is more useful to

1 those people?

2 THE WITNESS: That's correct.

3 COMMISSIONER GOLDWAY: Okay. Thank you.

4 CHAIRMAN OMAS: Thank you. Let me ask you
5 this, and if you want to think about it over a couple
6 of days, that's fine. As I mentioned, the Commission
7 found that there was essentially no reliable support
8 for the volume estimates offered in the Bank One case.
9 If your attorney advised you that your target engine
10 provided is sufficient reliable means for estimating
11 volumes, so as to be likely to justify your NSA, would
12 you be willing to provide it to the Commission under
13 protective conditions? Again, I understand that you
14 might want to have your attorney review the
15 Commission's protective condition before making a
16 decision.

17 THE WITNESS: So, you're saying, would I be
18 willing to provide our targeting methodology and
19 engine under --

20 CHAIRMAN OMAS: The protective conditions,
21 yes. And as I said, I'm not asking for an immediate
22 answer today. We would -- you can take a couple of
23 days. But, if you would like to give us one right
24 now, we would be happy to accept it.

25 THE WITNESS: I think that --

1 CHAIRMAN OMAS: Mr. May has worked with us
2 before under protective conditions and it stays here.

3 THE WITNESS: I would say on the surface,
4 yes. I think there's one other factor that we need to
5 consider and that is part of what the targeting engine
6 also considers is our budget. And the budgets are set
7 and our estimates of the budget are reflected in our
8 volume commitments over the next three-year period and
9 it's based on our best understanding of where
10 Washington Mutual is going and the growth that we need
11 and the credit-card organization to meet the needs of
12 the overall Bank. And so, there is one factor in this
13 targeting engine that needs to be considered and that
14 is the budget that we have for marketing over the
15 course of the next period.

16 CHAIRMAN OMAS: Is there a possibility that
17 that part of it be redacted and still be able to get -
18 - discern some information from that? I'm not
19 certain.

20 THE WITNESS: I think there's information
21 there, yes, that I think we could share. So, yes.

22 COMMISSIONER GOLDWAY: Great.

23 CHAIRMAN OMAS: Great. Thank you. Do you
24 have any idea of ways Washington Mutual Bank NSA is
25 sufficiently different from NSAs the Postal Service

1 has given other banks, as to justify three years of
2 uncapped discounts?

3 THE WITNESS: I think the most relevant
4 thing, from my understanding, is that we are making
5 commitments within the contract to convert our
6 standard class mail to first class. And if we don't
7 make those commitments, there are various penalties
8 that were discussed earlier. But, in addition to
9 that, I think it's relevant to point out that the
10 Postal Service, also, has the right to terminate this
11 agreement virtually unscathed, if they should see that
12 for whatever reason, we are either not making our
13 commitment or our volumes are different than what they
14 anticipated. I think that's a very relevant piece of
15 information here, because for the most part, this was
16 a risk that we knew we were taking when we entered
17 into this agreement, the risk that the Postal Service
18 could terminate with virtually no ramifications to
19 them. So, the risk that we're taking is, is if we
20 start moving down a path from a strategy standpoint,
21 to moving standard class to first class, and then the
22 agreement is terminated and no discounts are provided,
23 we have taken a tremendous loss in that situation.
24 Because, as I've mentioned, there's a portion of our
25 mailable population where standard class works, but

1 first class does not from a return on investment
2 standpoint. That, I think, is probably the most
3 relevant piece from where I sit, as to why it's
4 different than previous NSAs.

5 CHAIRMAN OMAS: Thank you, Mr. Rapaport. As
6 I said earlier, there's a number of questions from the
7 bench. Commissioner Goldway?

8 COMMISSIONER GOLDWAY: First of all, I want
9 to thank you for your honesty in your testimony and in
10 your written testimony and your frank discussion with
11 the Chairman today. As our questions have indicated,
12 both to the prior witness and now to you, we're
13 concerned about the possible inaccuracies in volume
14 forecasts and how that might, in some way, damage all
15 users of mail, even if it might benefit you and the
16 Postal Service in this particular agreement. So, I
17 guess we're trying to figure out how to be confident
18 in the accuracy of your forecasts. Certainly, the
19 willingness you expressed to share some of your
20 targeting formulas with us will help. When you do
21 those forecasts, and you've said that you're more
22 comfortable with one year than for two or three years,
23 is that correct, in general?

24 THE WITNESS: In general, it's correct, yes,
25 because there are various exogenous factors embedded

1 in our forecast, as time goes on.

2 COMMISSIONER GOLDWAY: What are some of
3 those exogenous factors?

4 THE WITNESS: The degree of competition in
5 our industry. You know, there could be various
6 effects. Obviously, something like an effect like
7 9/11 had on mailings. It's not something that we can
8 forecast, at this point. We, also, can't necessarily
9 forecast, as well as we would like, the degree to
10 which the -- how much of our mail volume, how our
11 response rates will hold up and, in addition to that,
12 how much of our business is going to be built from
13 mailings, as well as now from our branch network.
14 Because, as you know, historically, Providian National
15 Bank, which was acquired by Washington Mutual, did not
16 have a branch network. And selling through the
17 branches is something we've just begun, so our
18 knowledge of just how much we could expect from a
19 growth standpoint from the branches is still under
20 consideration. And with that said, we have particular
21 growth targets for the organization, for the bank, and
22 we are going to try and do our best to meet those
23 growth targets with the combination of mail, as well
24 as branch solicitations, if you will. And that's
25 something that we're still working our way through.

1 COMMISSIONER GOLDWAY: So, there's a whole
2 new area of marketing potential, other than mail, that
3 may factor in, in the next couple of years and change
4 the balance one way or another?

5 THE WITNESS: It could, but I think our
6 estimates take that into account as best as we can.

7 COMMISSIONER GOLDWAY: You forecast 450
8 million pieces of first-class mail in year one, if
9 there is no discount.

10 THE WITNESS: That's correct.

11 COMMISSIONER GOLDWAY: How accurate do you
12 think that forecast is?

13 THE WITNESS: I think it's very accurate and
14 we're trending very close to that through the first
15 three months of 2006 already.

16 COMMISSIONER GOLDWAY: Plus or minus 10
17 million? Fifteen million? Fifty million pieces of
18 mail? Can you give me a sense?

19 THE WITNESS: I'll say that I believe that
20 that number relative to our budget and relative to our
21 plans so far are within 10 to 20 million of accuracy.

22 COMMISSIONER GOLDWAY: Would you say that
23 your after rates volume forecast is more reliable than
24 your before rates volume forecast?

25 THE WITNESS: I think both forecasts are

1 equally reliable, based on if the NSA is approved, as
2 we've set out.

3 COMMISSIONER GOLDWAY: Do you think your
4 forecast will be in that same 10 to 20 million range,
5 in terms of accuracy?

6 THE WITNESS: Yes.

7 COMMISSIONER GOLDWAY: If we were all
8 comfortable with a volume forecast that was agreeable
9 among the parties, instead of a cap, would you be
10 willing to accept some sort of other risk-sharing
11 mechanism, if your actual volume fell outside that
12 comfort zone?

13 THE WITNESS: Depending on what that exactly
14 is, we would consider it.

15 COMMISSIONER GOLDWAY: Okay, good. Now, I
16 want to shift gears a bit and ask a couple of
17 questions about the Bank One reconsideration opinion.
18 Would you say that you understand the alternative
19 framework for NSAs, the one designed to avoid the need
20 for the Commission to judge the reliability of the
21 forecast? Do you understand what those are?

22 THE WITNESS: I don't think I'm an expert on
23 that, no.

24 COMMISSIONER GOLDWAY: While this case was
25 suspended, did you discuss with the Postal Service

1 working to possibly develop modifications to your
2 proposal that would follow the Bank One proposal more
3 precisely?

4 THE WITNESS: I don't believe so. I believe
5 most of the reconsideration during that time was
6 around our volumes.

7 COMMISSIONER GOLDWAY: Okay. So, you never
8 really did look at that as an option? You were just
9 looking at the volumes?

10 THE WITNESS: Not to my knowledge.

11 COMMISSIONER GOLDWAY: Okay. I don't think
12 I have any other questions. Thank you.

13 CHAIRMAN OMAS: Commissioner Hammond?

14 COMMISSIONER HAMMOND: Yes, I have a
15 question or two. Good afternoon, Mr. Rapaport.

16 THE WITNESS: Good afternoon.

17 COMMISSIONER HAMMOND: As I discussed
18 earlier with the Postal Service witness this morning,
19 which you mentioned, there's a penalty or a fine
20 involved in this NSA, if Washington Mutual essentially
21 doesn't mail a certain volume under the agreement and
22 all. I just wanted to see if you could tell me why,
23 from the other side, from your perspective, why
24 \$250,000 is the correct amount in this instance? I
25 assume you would have preferred nothing. I assumed

1 the Postal Service would like to have tripled it.
2 But, I'm trying to get to why is this a correct amount
3 for something, for considering what is involved in
4 this particular NSA?

5 THE WITNESS: As far as how the \$250,000 was
6 set, I think that was a proposal made to us from the
7 Postal Service. We, then, evaluated it, in the
8 context of what is the probability of that that
9 scenario would come to pass; and if that scenario came
10 to pass, could we afford or could we handle the
11 \$250,000 penalty. And we came to the conclusion that
12 it was something that we were willing to agree to. We
13 have hopefully no intention of having to go that
14 route, because our intention is to meet the
15 requirements of the NSA, as defined. But, if by some
16 chance either our volume commitments weren't there or
17 we could not commit to converting 90 percent of our
18 volume to first class, we determined that in that
19 unforeseen circumstance, we would be willing to pay
20 that penalty.

21 COMMISSIONER HAMMOND: Okay. Now, you are
22 the marketing man, basically; right?

23 THE WITNESS: Both the -- I am the marketing
24 man from the standpoint of my team runs the analysis
25 that goes into determining who we mail and, also, the

1 execution of that mail, working with our direct
2 marketing agencies, letter shops, et cetera.

3 COMMISSIONER HAMMOND: Are you responsible
4 only for Washington Mutual's direct mail campaign or
5 are you involved in other advertising for Washington
6 Mutual?

7 THE WITNESS: Basically, I'm just
8 responsible for the credit card side of our direct
9 marketing, so not the broader advertising campaign
10 that Washington Mutual is a part of.

11 COMMISSIONER HAMMOND: Okay. I just wanted
12 to get to your expertise in this --

13 THE WITNESS: I understand.

14 COMMISSIONER HAMMOND: -- particular field.
15 Okay, great. That's the only thing I have. Thank
16 you, very much.

17 CHAIRMAN OMAS: Thank you, Commissioner
18 Hammond. Mr. May, would you like some time with your
19 witness?

20 MR. MAY: Yes, Mr. Chairman.

21 CHAIRMAN OMAS: Okay, thank you. We will
22 take a five-minute break.

23 (Whereupon, a short recess was taken.)

24 CHAIRMAN OMAS: Mr. May?

25 MR. MAY: Mr. Chairman, for the record, I

1 would like to clarify one of the answers that Mr.
2 Rapaport made. While he did not have discussions with
3 the Postal Service about the implications of the Bank
4 One case and the Brookbank's case, I conducted
5 discussions with the Postal Service and our consultant
6 did with the Postal Service people. But, Mr. Rapaport
7 did not. But, we, indeed, did have discussions.

8 CHAIRMAN OMAS: Okay, thank you.

9 MR. MAY: I would like to take you back to
10 the --

11 CHAIRMAN OMAS: Would you like to share what
12 those discussions were?

13 MR. MAY: Yes. Whether or not -- first of
14 all, was whether or not there was a way to do the
15 Panzer test and the Postal Service's position is that
16 they simply didn't have -- we only had one equation
17 and two unknowns. So, we had no way to get the
18 correct elasticities to perform the Panzer test
19 correctly and consistently. And I believe that's in
20 one of their responses to OCA. And that was generally
21 it and that was the position they took. And so, that
22 was kind of the end of that discussion, as such. It
23 was could we really do the test and, if we did, let's
24 do it and what does it show. In fact, they couldn't
25 and our own consultant couldn't do it. You could kind

1 of guess of what it might show, but had no way to
2 really do it, or so we thought. So, indeed, we
3 thought more in terms of other kinds of changes in the
4 deal that might give comfort to the Postal Service --
5 to the Commission and the Postal Service about being
6 assured that they're not going to give discounts on
7 anyhow mail, at least to some protection. And,
8 indeed, I intend to follow up with the witness on some
9 of that discussion, because it relates to questions
10 about the Chair and others have asked, if I could
11 proceed.

12 BY MR. MAY:

13 Q But, first of all, you were describing these
14 differences between Bank One and Washington Mutual.
15 Are there other business differences in the -- their
16 deal, which was capped, and the cap that you might
17 have to live with?

18 A Right. The other thing that I would say,
19 and it's in our testimony, as well, the caps, as they
20 were applied in the Bank One case and other cases,
21 those deals were able to continue for whatever reason.
22 In our situation, we've analyzed that a cap based
23 purely on cost savings would not work for us. It
24 would not justify the entire move from standard to
25 first class that we've talk about and it wouldn't

1 justify the additional costs that we would have to
2 incur to make those changes that the NSA requires.
3 So, I think that's another fundamental difference in
4 our analysis. For whatever reason, we appear
5 different than some of the others, in the case that
6 the caps at cost savings would just not make the deal
7 viable for us.

8 Q Commissioner Goldway, also, asked you
9 whether you had any ideas about other ways you could
10 give assurances to the Commission, other than the
11 kinds of caps they've employed in the past. And I
12 don't think you really fully answered that. If you
13 could supply a fuller answer?

14 A One other thought that we've had is that our
15 estimates of volume that we have in our testimony is
16 our best estimates of what we think will happen over
17 the next couple of years. We would be willing to
18 consider a proposal, whereby if we exceed those
19 estimates, then no additional discounts would be
20 forthcoming. So, that's another way that we feel we
21 could satisfy what we would need from this deal to
22 make it worthwhile, to do what we've set out that we
23 were going to; but, at the same time, potentially
24 prevent any kind of additional risk to the Postal
25 Service from the concept of anyhow mail. So, that

1 would be one idea.

2 Q I mean, in effect, you would be treating the
3 surplus mail as anyhow mail?

4 A That's correct.

5 Q That's the assumption, would be basically no
6 discount on it.

7 MR. MAY: That's all, Mr. Chair.

8 CHAIRMAN OMAS: Thank you, Mr. May, Mr.
9 Rapaport. That completes your testimony here today.
10 We appreciate your cooperation, your appearance, and
11 your contribution to the record. We do appreciate it
12 and thank you.

13 THE WITNESS: Thank you.

14 CHAIRMAN OMAS: This hearing is adjourned.

15 (Whereupon, at 1:07 p.m., the hearing in the
16 above-entitled matter was concluded.)

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REPORTER'S CERTIFICATE

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I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Postal Rate Commission

Date: 7/31/06

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